NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS

Congressional Information Service
Washington, D.C.

S. Hrg. 101-508

AIRLINE COMPETITION ENHANCEMENT ACT OF 1989

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 1741

TO AMEND THE FEDERAL AVIATION ACT OF 1958 TO INCREASE COMPETITION AMONG COMMERCIAL AIR CARRIERS AT THE NATION'S MAJOR AIRPORTS, AND FOR OTHER PURPOSES

NOVEMBER 8, 1989

Printed for the use of the
Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE
26-036 O WASHINGTON : 1990

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

S261-30

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ERNEST F. HOLLINGS, South Carolina, *Chairman*

DANIEL K. INOUYE, Hawaii
WENDELL H. FORD, Kentucky
J. JAMES EXON, Nebraska
ALBERT GORE, JR., Tennessee
JOHN D. ROCKEFELLER IV, West Virginia
LLOYD BENTSEN, Texas
JOHN F. KERRY, Massachusetts
JOHN B. BREAUX, Louisiana
RICHARD H. BRYAN, Nevada
CHARLES S. ROBB, Virginia

JOHN C. DANFORTH, Missouri
BOB PACKWOOD, Oregon
LARRY PRESSLER, South Dakota
TED STEVENS, Alaska
ROBERT W. KASTEN, JR., Wisconsin
JOHN MCCAIN, Arizona
CONRAD BURNS, Montana
SLADE GORTON, Washington
TRENT LOTT, Mississippi

KEVIN G. CURTIN, *Chief Counsel and Staff Director*
WALTER B. MCCORMICK, JR., *Minority Chief Counsel and Staff Director*

SUBCOMMITTEE ON AVIATION

WENDELL H. FORD, Kentucky, *Chairman*

J. JAMES EXON, Nebraska
DANIEL K. INOUYE, Hawaii
JOHN F. KERRY, Massachusetts
LLOYD BENTSEN, Texas

JOHN MCCAIN, Arizona
TED STEVENS, Alaska
ROBERT W. KASTEN, JR., Wisconsin

CONTENTS

Page
Opening statement by Senator Ford 1
Opening statement by Senator McCain 2
Opening statement by Senator Danforth 3
Opening statement by the Chairman 5
Opening statement by Senator Pressler 6
Text of S. 1741 7

LIST OF WITNESSES

Beauvais, Edward R., chairman and CEO, America West Airlines, Inc 58
  Prepared statement 61
  Questions of Senator Ford and the answers 69
Callison, James W., senior vice president, legal and corporate affairs, and secretary, Delta Air Lines, Inc 81
  Prepared statement 87
  Questions of Senator Ford and the answers 112
Cooper, Dr. Mark, research director, Consumer Federation of America 130
  Prepared statement 133
Crandall, Robert L., chairman and president, American Airlines, Inc 17
  Prepared statement 23
  Questions of Senator Ford and the answers 45
Metzenbaum, Hon. Howard, U.S. Senator from Ohio 15

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Magary, A.B., executive vice president-marketing, Northwest Airlines, statement 182
Minnesota Department of Transportation, Office of Aeronautics, statement 172
Styles, Michael H., regional director, U.S. International Air Transport Assn., statement 167

AIRLINE COMPETITION ENHANCEMENT ACT OF 1989

WEDNESDAY, NOVEMBER 8, 1989

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION,
Washington, DC.

The subcommittee met pursuant to notice, at 9:32 a.m., in room SR-301, Russell Senate Office Building, Hon. Wendell H. Ford (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Carol Carmody, professional staff member; Steve Palmer, senior professional staff member; and John Timmons, minority staff counsel.

OPENING STATEMENT BY SENATOR FORD

Senator FORD. Good morning, ladies and gentlemen. This morning the Aviation Subcommittee is holding the first of several hearings on S. 1741, a bill introduced by Senators Danforth and McCain to increase the competition among commercial air carriers at major airports.

We have had a number of hearings on the subject of concentration and competition in the airline industry, and have identified a number of areas of concern to the members of the Commerce Committee.

S. 1741 proposes a variety of remedies, including divestiture of the computer reservation system, auctioning of slots, strengthening the Department of Transportation's authority to take action against unfair practices, eliminating code-sharing, permitting airports to charge head taxes.

I am inclined to think that some of the proposed solutions are pretty drastic and might create more problems than they solve. I am not sure that forcing airlines to sell their computer reservation systems would be fair or useful. Who would buy the systems?

By leveling the playing field, as the bill seeks to do, are we not penalizing those airlines who had the foresight and the initiative to develop such systems and market them successfully?

The head tax proposal bothers me as well, especially with a 7 billion dollar balance sitting in the airport and airway trust fund. I resist taxing the traveling public again when their tax dollars are not now being put to the intended use.

The hearings we have held in the past identified some concerns held by a number of Senators on the Commerce Committee. It is obvious that there has been increased concentration in the industry, that fares at concentrated hubs have risen faster than fares at unconcentrated hubs, and that barriers to entry exist at slot-controlled and congested airports.

I believe the bill contains some ideas which bear further examination.

We have witnesses this morning from the airline industry, both large and small carriers, as well as witnesses from the Consumer Federation of America. I will be interested to hear what they have to say about the provisions of the bill and what solutions they propose for the concerns I have identified.

We are delighted to have Senator Metzenbaum here this morning to start off the hearing. He shares our interest in air safety and is concerned about service and fares in the deregulated industry.

Before I call on Senator Metzenbaum for his testimony, I want to recognize the ranking member of the subcommittee. John.

OPENING STATEMENT BY SENATOR McCAIN

Senator McCAIN. Thank you, Mr. Chairman, and I would like to thank you for convening the Aviation Subcommittee so promptly on S. 1741, the Airline Competition Enhancement Act of 1989.

I also appreciate your commitment to myself and Senator Danforth to fashion legislation which will address the problems afflicting the airline industry. I recognize that we do have some differences. I have confidence that we can work them out.

As I have said many times before, I come at this problem as one who supports economic deregulation, as one who is committed to making airline deregulation work. I am convinced that the greatest threat to this goal is a creeping de facto reregulation which increasingly engulfs the industry.

As we meet today, two more airlines are on the brink of extinction, several other airlines are in the critical care unit, and only two post-deregulation carriers remain. This scene, Mr. Chairman, does not comport with the vision of deregulation.

Instead of proliferation of choices, consumers are increasingly faced with little or no choice. However, deregulation was not always this way. In the first half of this decade, consumers had plenty of choice. They could fly with no frills, all the frills, or somewhere in between.

Only if we discover and correct the causes that led to the diminution of this choice will consumers receive the long-term benefits of deregulation. This subcommittee, under Chairman Ford's leadership, has engaged in a long and laborious process attempting to understand the problems of the industry and fashion solutions to them.

It is my view that the airlines started to flex their market power initially with computer reservation systems, CRSs. The merger mania which occurred in the 1985–87 time frame resulted in the complete disappearance of mid-sized carriers, such as Republic and Ozark, and the consolidation of the industry into a few major carriers, each owning all or a piece of a CRS. The exception to this is Pan Am.

Numerous studies have highlighted the monopoly power of the CRS. These include two Department of Justice studies, two Civil

Aeronautics Board studies, a GAO study, and a Department of Transportation study.

Many lessons can be drawn from these studies. However, I believe only three are relevant: One, you need a CRS if you are to survive and grow in the airline business; two, it is impossible for a new system to be formed either by an airline or a non-airline; three, the dominant CRS vendors are being enriched at the expense of other competitors.

The conclusion I reach based on these lessons is that, if you want competition to flourish, you must separate airlines from CRSs.

In addition to the CRS, I believe the efforts of this subcommittee have outlined the problems associated with the concentrated hub and slots. Hubs per se are not anti-competitive. They have provided the American consumer with numerous benefits, and it is my desire that they keep providing these benefits to the traveling public.

However, when companies retreat into their hubs, denying entry to other competitors, and take advantage of other tactics to squelch competition, they inhibit the realization of the goals of deregulation. Practices which result in the so-called fortress hub must be attacked and eliminated.

Mr. Chairman, I do not really have anything to say about slots that I have not said numerous times before. I regret their existence, but as long as we have them, all should have access on an equitable basis.

I have extended an invitation to the airlines and other interested parties in the past to work together to reverse the trends of the past couple of years. Each of the last 2 years has seen a doubling of ticket price increases. I am confident that the Congress will not allow this to continue.

We can address this trend in one of two ways: competition or regulation. My preference is competition.

Thank you, Mr. Chairman.

Senator FORD. Thank you, Senator McCain.

We are joined by the distinguished ranking member of the full committee, Senator Danforth. Do you have any statement this morning?

OPENING STATEMENT BY SENATOR DANFORTH

Senator DANFORTH. Mr. Chairman, I have only this short statement. I thank you for holding this hearing. This is exactly what Senate hearings should be about. This is a subject which is not new to the Commerce Committee.

We have had in the recent past the benefit of three different studies by the General Accounting Office, one study by the Department of Transportation, of the problem of concentration in the airline industry. We have had several hearings in the Commerce Committee on the subject of those studies.

We now have a bill before us which is built upon the work of the General Accounting Office and the Department of Transportation. I think that it is very sound work and I am glad that we are proceeding with the work on the bill itself.

It is clear to me that the worst of all worlds is an industry that is neither regulated nor competitive, and that is the situation with the airline industry today. Senator Metzenbaum has a proposal which would provide for reregulation of the industry.

Senator McCain and I and others suggest building on the work of the various studies that have been done, and moving toward a more competitive system, rather than a reregulated system. They are two different approaches, but both of them recognize that the worst of all worlds is an industry which is neither regulated nor competitive, and that is the airline industry today.

Senator FORD. Thank you, Senator Danforth.

I have opening statements from Senators Hollings and Pressler that I will include in the record at this point.

[The statements and bill follow:]

OPENING STATEMENT BY THE CHAIRMAN

In the eleven years since enactment of the Airline Deregulation Act of 1978, this Committee has focused a great deal of time examining the condition of the airline industry, and addressing the question of whether air travelers are better off without government intervention. With the introduction of S. 1741, there can be little doubt that that examination must again be renewed.

My original inclination in 1978 was to question the wisdom of airline deregulation. However, I was persuaded at that time that the bill contained adequate safeguards for small and medium-sized communities against changes that were destined to occur in a deregulated environment. I was also persuaded that the 1978 Act retained adequate Federal authority to preclude predatory airline practices and continue strong effective antitrust enforcement.

During those eleven years, we have had to continuously revisit these concerns, as low-cost airlines like People Express have come and gone, as airline mergers have eliminated competition between carriers, and now, as Wall Street threatens the future well-being of the airline industry.

The conclusion is very simple: I am a born-again regulator. By saying this, I am not advocating an absolute return to an era of pre-1978 regulation. However, something must be done to bring the airline industry back in line with the needs of the traveling public.

In this light, while I cannot unilaterally endorse either of the proposals now on the table, I welcome them. In recent years, I have outlined similar proposals, only to realize that the time for a political consensus is not right. Well, it appears that that time may be fast approaching.

Again and again, I hear my colleagues complaining about airline service and about the escalating fares that they and their constituents are forced to pay. We must have an air transportation system that is capable of providing quality service at affordable prices to all people.

In my view, this is particularly important for people in small and medium-sized communities. Airline deregulation was not enacted to merely benefit those flying from New York to Los Angeles. In order to be a success, it must benefit the people of Charleston, Myrtle Beach, Columbia, and Greenville-Spartanburg. Air travelers in these cities, and countless others in similar sized cities in other States, have shouldered the costs of deregulation.

I look forward to these hearings. I expect to play an active role in working with my colleagues on the Aviation Subcommittee in shaping any legislation that may result from these hearings. It is our challenge, as well as our responsibility, to ensure that this Nation's airlines serve the needs of the American people.

OPENING STATEMENT BY SENATOR PRESSLER

Mr. Chairman, today's hearing is the result of intense scrutiny of the airline industry by this subcommittee. I commend Senators Danforth and McCain for the leadership they have demonstrated in this area and for the tenacity with which they have tackled this problem.

The lack of competition in the airline industry has lead to higher fares and a deterioration of service. This is evident in South Dakota and other states where travelers have little or no travel options.

The General Accounting Office (GAO) has provided us with some strong evidence in support of S.1741. Airlines that dominate a hub airport have fares that are nearly thirty percent higher than at unconcentrated airports. Smaller airlines, like Braniff, are having difficulty competing in this environment.

Today's hearing is a positive step toward addressing some of these problems. I look forward to examining today's testimony from representatives of the airline industry and the Consumer Federation of America. Mr. Chairman, thank you for scheduling this important hearing.

101st CONGRESS
1st Session

S. 1741

To amend the Federal Aviation Act of 1958 to increase competition among commercial air carriers at the Nation's major airports, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 6 (legislative day, SEPTEMBER 18), 1989

Mr. McCAIN (for himself, Mr. DANFORTH, and Mr. BOND) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

---

A BILL

To amend the Federal Aviation Act of 1958 to increase competition among commercial air carriers at the Nation's major airports, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Airline Competition Enhancement Act of 1989".

COMPUTER RESERVATION SYSTEMS

SEC. 2. Title IV of the Federal Aviation Act of 1958 (49 App. U.S.C. 1371 et seq.) is amended by adding at the end the following new section:

"SEC. 420. COMPUTER RESERVATION SYSTEMS.

"(a) NONDISCRIMINATORY ACCESS.—The Secretary of Transportation shall ensure that computer reservation systems are available on a nondiscriminatory basis to all air carriers, ticket agents, and other persons.

"(b) PROHIBITION.—After January 20, 1991, no air carrier or air carrier affiliate shall own, operate, or control a computer reservation system.

"(c) CODE SHARING.—After the date that is ninety days following the date of enactment of this section, an air carrier—

"(1) shall not share or authorize the sharing of its designator code with another air carrier for computer reservation purposes or any other purpose; and

"(2) shall not, with respect to any flight for which it is responsible, use or permit the use of the designator code of another air carrier to identify such flight for any purpose.

"(d) REGULATIONS.—The Secretary shall prescribe such regulations as the Secretary determines appropriate to carry out this section.

"(e) DEFINITIONS.—In this section, the term—

"(1) 'air carrier affiliate' means any person who, directly or indirectly, owns or controls an air carrier or is owned or controlled by an air carrier;

“(2) ‘computer reservation systems’ means any computerized or automated system which has the ability to allow a ticket agent, air carrier, or other person to—

“(A) obtain information on routes, arrival and departure schedules, and fares of flights of air carriers; and

“(B) make reservations on flights of air carriers or issue tickets for an air carrier; and

“(3) ‘designator code’ means the unique designation code allotted to an air carrier by the Secretary of Transportation.”.

FEDERAL TRADE COMMISSION AUTHORITY

“SEC. 3. Section 5(a)(2) of the Federal Trade Commission Act (15 U.S.C. 45(a)(2)) is amended by striking “air carriers and foreign air carriers subject to the Federal Aviation Act of 1958,”.

DOMINANT AIR CARRIERS

SEC. 4. Section 411 of the Federal Aviation Act of 1958 (49 App. U.S.C. 1381) is amended by adding at the end the following new subsection:

“DOMINANT AIR CARRIERS

“(c)(1) An air carrier operating aircraft at a concentrated hub airport shall be presumed to have been engaged in unfair or deceptive practices or unfair methods of competition in air transportation (or the sale thereof) if the air carrier is a dominant air carrier at that airport.

"(2) In this subsection, the term—

"(A) 'concentrated hub airport' means an airport that has 0.25 per centum or more of the total annual enplanements in the United States and that is determined by the Secretary of Transportation to exceed 1800 on the Herfindahl-Hirschman Index as measured in terms of market shares of passenger enplanements on all air carriers other than charter air carriers; and

"(B) 'dominant air carrier' means an air carrier whose aircraft at a concentrated hub airport have 40 per centum or more of the passenger enplanements at the airport or an air carrier which is one of two air carriers whose aircraft at a concentrated hub airport together have 60 per centum or more of the passenger enplanements at the airport; and

"(C) 'Herfindahl-Hirschman Index' means the numerical index of market concentration calculated by adding the squares of the individual market shares of all the firms in a market.".

INJUNCTION AUTHORITY

SEC. 5. Section 411(a) of the Federal Aviation Act of 1958 (49 App. U.S.C. 1381(a)) is amended—

(1) by inserting "(1)" immediately after "(a)"; and

(2) by adding at the end the following new paragraph:

"(2) If the Secretary of Transportation has reason to believe that any air carrier, foreign air carrier, or ticket agent has been or is engaged in unfair or deceptive practices or unfair methods of competition in air transportation (or the sale thereof) and that enjoining such practices or methods would be in the interest of the public, the Secretary may bring suit in a district court of the United States to enjoin such practices or methods. Any such suit shall be brought in the district in which the air carrier, foreign air carrier, or ticket agent resides or transacts business.".

PASSENGER FACILITY CHARGES

SEC. 6. Section 1113 of the Federal Aviation Act of 1958 (49 App. U.S.C. 1513) is amended—

(1) by redesignating subsection (d) and any reference thereto as subsection (e);

(2) in subsection (a), by striking "No" and inserting in lieu thereof "Except as provided in subsection (d) of this section, no"; and

(3) by inserting immediately after subsection (c) the following new subsection:

"(d)(1) Subject to the requirements of this section, the operator of any concentrated hub airport may, to generate revenue for security, capacity enhancement, and noise mitigation projects at such airport, assess a charge on passengers enplaning at such airport.

"(2) No charge may be assessed under this section unless the Secretary of Transportation has determined, after notice and an opportunity for a hearing, that the proposed assessment is in the public interest and in accordance with the public convenience and necessity.

"(3) The Secretary of Transportation may issue such regulations as the Secretary determines are appropriate to carry out the provisions of this subsection.

"(4) In this section—

"(A) 'concentrated hub airport' means an airport that has 0.25 per centum or more of the total annual enplanements in the United States and that is determined by the Secretary of Transportation to exceed 1800 on the Herfindahl-Hirschman Index as measured in terms of market shares of passenger enplanements on all air carriers other than charter air carriers; and

"(B) 'Herfindahl-Hirschman Index' means the numerical index of market concentration calculated by adding the squares of the individual market shares of all the firms in a market.".

SLOT ALLOCATIONS

SEC. 7. (a) No later than one hundred eighty days after the date of the enactment of this Act, the Secretary of Transportation shall implement a final rule that amends subpart S of part 93 of title 14, Code of Federal Regulations, to provide for the withdrawal and transfer, by auction, of slots held by air carriers and foreign air carriers at high density traffic airports.

(b) The final rule required to be implemented under subsection (a) shall be designed to enhance competition by encouraging the new entry of air carriers at high density traffic airports and shall—

(1) provide for the periodic auction of such slots for specific lengths of time;

(2) require that the holder of a slot make a specified minimum percentage of use of the slot and that if the holder fails to meet such minimum use requirement, the slot shall be returned to the Secretary of Transportation;

(3) include provisions designed to limit market concentration at high density traffic airports;

(4) take into account the responsibilities of the Secretary of Transportation with respect to small community air service under section 419 of the Federal Aviation Act of 1958 (49 App. U.S.C. 1389) and the international law and treaty obligations of the United States; and

(5) include such other provisions and requirements as the Secretary determines to be in the public interest

and in accordance with the public convenience and necessity.

(c) The proceeds from any auction under the final rule required to be implemented under this section shall be credited to the Airport and Airway Trust Fund established by section 9502 of the Internal Revenue Code of 1986 (26 U.S.C. 9502), to be used for projects to enhance airport capacity.

(d) As used in this section—

(1) the terms "air carrier" and "foreign air carrier" have the meaning given those terms in section 101 of the Federal Aviation Act of 1958 (49 App. U.S.C. 1301); and

(2) the term "high density traffic airport" means any airport so designated under subpart K of part 93 of title 14, Code of Federal Regulations, including any airport so designated following the date of enactment of this Act.

Senator FORD. Our first witness then this morning is the Honorable Howard Metzenbaum, U.S. Senator from Ohio. Senator Metzenbaum, we are very pleased to have you and you may proceed.

STATEMENT OF HON. HOWARD METZENBAUM, U.S. SENATOR FROM OHIO

Senator METZENBAUM. Thank you, Mr. Chairman, to you and the other members of this committee. I feel privileged to be here before you, and I think that the Danforth-McCain bill, the Ford bill, which is awaiting action on the Senate calendar as I understand it, and the legislation which Senator Byrd and I expect to introduce today are all indications that there is something wrong with the airline industry today, and it is a matter of great concern to the American people.

Now, today Senator Byrd and I will introduce legislation to reregulate the domestic airline industry with respect to fares, routes, service, and safety. I must tell you that in some respects I am about to make somewhat of a paraphrase of what Senator Danforth was widely quoted on recently, and that is where he said he made a mistake in connection with a legislative matter.

I am prepared to say I made a mistake, because I supported deregulation of the airline industry, and I even took the absurd position of supporting deregulation of the telephone industry, and that sure as the devil has not worked out well.

The time has come to face the fact that deregulation has not lived up to our expectations. Now, I am frank to say to you that I am not certain that reregulation is the right solution, but I am certain that deregulation was the wrong solution.

I think it is important to put the idea of reregulation on the table. Not everybody is going to like the idea, but it is a proposal that I believe should be debated. Congress passed legislation in 1978 to sunset the Civil Aeronautics Board because the airlines said it was government regulation that was stifling competition. Congress bought that bill of goods, so we deregulated the airline industry.

At first the promises of deregulation came true. New airlines sprang up, fares went down, and more people than ever were flying. Some might call the period right after deregulation, the time of People Express and New York Air and Laker Airlines, the time of the "friendly skies."

But then the Reagan Administration betrayed the whole notion of deregulation. It interpreted deregulation to mean no regulation. While the Department of Transportation has authority to oversee airline route mergers, it approved every single merger that was proposed. The Department of Transportation even approved two mergers that the Department of Justice Antitrust Division opposed, the merger of TWA and Ozark and the Northwest-Republic merger.

Now, eight airlines control 90 percent of the air travel in this country, and we are only beginning to see what the future holds if Congress does not take some affirmative steps. Discount fares, when available, come with more restrictions and higher penalties. Direct flights no longer are available to many cities. Delays and cancellations are the rule, not the exception. And while air travel is generally safe, there has been a rash of air disasters since deregulation has underscored that all is not well in this area, either.

I am aware of the fact that Senators on this committee, Senators Danforth, McCain, I understand Bond as well, have introduced legislation to deal with the problems of airline competition, and I commend them for taking on a difficult issue and proposing a number of very innovative ideas, many of which I support, but some of which I think I have some reservations.

However, my opinion is their bill does not go far enough. Now, the bill we are introducing today would establish a new independent airline policy board to regulate rates and routes of domestic carriers. It would require the Department of Transportation to establish a 24-hour hotline for air passengers to call for information and to help in resolving disputes with airlines.

It would prevent airlines from cancelling flights for purely economic reasons without giving the passengers prior notice. And it would require airlines to provide infant safety seats, and would require the Department of Transportation to address the problem, which I consider to be a major problem, of aging aircraft.

I am frank to say I do not know if complete reregulation is the answer. I do know it is time that we owned up to the fact that airline deregulation was a mistake.

While this legislation is far-reaching, I believe that the plight of American air passengers leaves us little choice. Unless Congress steps in, airlines will continue to pilot the industry toward disaster.

I might say, Mr. Chairman, members of this committee, I think there is somewhat of a sense of urgency about this. We just saw two airlines closing their doors within this week's period. I am concerned about what further steps will be taken as far as closures are concerned.

I know that it used to be that if you wanted to fly from Columbus to Boston or Cleveland to Miami, you could get a direct flight. You can get a direct flight now, but you may have to stop one or two places on the way. You may also have to change planes. This whole concept of hubs may make good sense as far as Federal Express and business such as that are concerned, but I am not sure it makes good sense as far as the American people are concerned.

Mr. Chairman, members of the committee, I appreciate the opportunity to appear before you.

Senator Ford. Thank you, Senator Metzenbaum.

I have not had a chance to scrutinize your bill. I had the opportunity only last night to glance at it, so it is difficult for me to ask you any questions. I have some real problems about the imposition of restrictions upon businesses that, I do not believe they can carry out.

Your bill would prohibit advertising of a fare unless a third of the seats are available at that fare. Well, a third of the seats may have been available when they put the ad in the paper. I do not know when they put the ad in the paper, on the radio, or on the TV, that tomorrow seats are available at a certain price.

I appreciate your interest in my leveraged buyout legislation. I think that is important. Our side is ready to go and several on the other side are ready to go. I see them here smiling with me, but we have a little problem down the street.

So I thank you for your testimony and I turn any questions over to my colleagues.

Senator McCain. I have no questions. Thank you, Senator.

Senator Ford. Jack.

Senator Danforth. Thank you very much, Senator Metzenbaum.

Senator Metzenbaum. Thank you.

Senator Ford. Thank you.

Our first witness this morning is the chairman and president of American Airlines, Inc., Mr. Robert Crandall. Mr. Crandall, we appreciate you being here this morning and look forward to your testimony.

You may proceed.

STATEMENT OF ROBERT L. CRANDALL, CHAIRMAN AND PRESIDENT, AMERICAN AIRLINES, INC.

Mr. Crandall. Thank you, Mr. Chairman. I am very glad to have an opportunity to come before you today to talk about S. 1741, which is intended to enhance competition among airlines.

Let me say at the outset that I share this committee's desire for a fully competitive air transportation system. While my remarks will be critical of certain aspects of S. 1741 and while I disagree vigorously with a number of its provisions, I do not quarrel with the objectives of its authors.

The bill addresses six distinct aspects of the airline business and it is a major step in the direction of reregulation. I also believe that the overall effect of this legislation will be to diminish,, not to enhance, competition. When we talk about competition in the airline business, we really need to be sure that we are focusing on what really counts, which is competition in city pair markets. People do not buy transportation in bulk. They buy service from one point to another.

In my view, S. 1741 would do nothing to enhance competition in city pair markets. To the contrary, by interfering with the marketplace in various ways, it will lead inevitably to a reduction in the level of city pair competition.

For all those reasons, we believe that enactment of the bill would be a serious mistake.

Let me address first computer reservation systems. The requirement of the bill that air carriers divest themselves of their computer reservation systems is a truly extraordinary exercise of legislative power. This unprecedented proposal is based on four claims made by CRS critics:

First, that CRS booking fees are too high;

Second,, that the business is non-competitive;

Third, that airlines who are CRS vendors enjoy a competitive advantage over airlines that failed to invest in CRS a decade ago;

And fourth, that the systems have been a primary cause of the failure of new entrant air carriers.

Those criticisms are unjustified, and I should like to say a word about each one of them. First, the notion that booking fees are too high simply does not stand up under scrutiny. All five CRS vendors charge similar fees. They are modest when compared with those of comparable services, such as Ticketron, and they provide good value for our customers.

Moreover, while we earn a very reasonable return on SABRE, some CRS vendors are only marginally profitable. At least one vendor is operating at a loss.

Forcing airlines to divest their CRS operations will not reduce booking fees. It will almost certainly cause them to increase.

I believe it is a certainty that non-airline vendors would promptly restore the use of preferential listings as a means of increasing CRS profitability; and thus forced CRS divestiture would be costly to airlines and will result in a lower standard of service to consumers.

As to competition in the CRS business, since there are five active CRS vendors, the view that competition is lacking has always puzzled me.

This committee cannot lose sight of the fact that a decade ago American Airlines urged development of a joint industry computer reservation system. But the U.S. Government was unenthusiastic and other airlines were unwilling to participate. Thus, the CRS business evolved in the only way that it could, with a few airlines taking heavy risks while others elected to stand on the sidelines.

Whatever might be the result of forced divestiture, you can be sure it will not make the CRS business more competitive.

Then there is something called the halo effect. Years ago it was claimed that airline CRS vendors enjoyed a competitive advantage because of bias in the displays and access to confidential booking data. As a consequence of DOT's rules, those advantages are gone. So our critics now point to the so-called halo effect of CRS sponsorship.

We do get a premium share of business from travel agents who are SABRE subscribers, but we got an even larger share in the 1960's before CRS was ever invented. The phrase "halo effect" is simply descriptive of good customer relationships, which it seems to me is what competition is all about.

Those who believe that legislative divestiture of airline-owned CRS's would somehow promote greater competition are in my view simply wrong. The only possible result would be to take away from those who developed the systems the rewards of doing so, and that it seems to me would be shabby treatment indeed.

The notion that computer reservation systems had an adverse impact on new entrants is the exact opposite of the facts. By means of CRS's, the services of new entrant airlines are made immediately available to travel agents all over the world, indeed all across this Nation.

The fees that new entrants pay for bookings obtained through CRS's are much less than what it costs them to create bookings themselves.

There is another aspect of this which relates to foreign flag CRS's. For a good many years, our Government has been willing to tolerate a variety of factors that give foreign flag carriers a competitive advantage over U.S. airlines on international routes. It is therefore imperative that this committee weigh the implications of the fact that foreign flag carriers are investing heavily in computer reservation systems and are forming consortiums to market them to travel agents abroad.

Assuming for purposes of argument that an airline does derive a competitive advantage from ownership of a CRS, an assumption it seems to me that is inherent in this legislation, then a requirement that U.S. flag carriers divest themselves of their CRS's while foreign flag carriers continue to develop and market them would be patently injurious to the ability of U.S. flag carriers to compete on international routes and contrary to our Government's objective of expanding U.S. flag carriers' presence abroad.

A second subject addressed by the bill is code-sharing. American is on record as believing that code-sharing in any form and in any market is a deceptive practice, but no carrier will abandon the practice unilaterally for competitive reasons. Nevertheless, we do not believe that legislation banning it is required.

It seems to us that the problems inherent in code-sharing, which are real, will either be worked out in the marketplace or handled by DOT rules.

A third subject is the authority of the Federal Trade Commission. When the final stage of deregulation was about to become effective, American urged the repeal of both the FTC exemption and section 411 of the Federal Aviation Act. We continue to hold that view today and we believe that airlines should be treated the same as other companies in unregulated industries with respect to unfair competition and deceptive trade practices.

If the FTC exemption were to be repealed, but section 411 retained, the effect would be to create identical jurisdiction in both the FTC and the DOT over unfair competition and deceptive trade practices.

Another subject addressed by the bill is that of dominant air carriers. The provisions concerning what are defined as concentrated hub airports and dominant air carriers, if ever enacted into law, would produce a truly extraordinary upheaval in the route systems of every major and national air carrier.

I sense that the intent of the authors of S. 1741 is to convert today's one- and two-carrier hubs into three- or four-carrier hubs, in which market shares are about equally divided. Mr. Chairman, that is simply an impossibility. Let me give you an example.

In 1987 American opened a new hub at Raleigh-Durham, North Carolina. A $120 million terminal was constructed at our expense for this purpose. Prior to the opening of the hub, nine carriers operated a total of 84 departures a day at Raleigh-Durham. Piedmont's 25 daily departures constituted a 30-percent market share.

Today American operates a total of 116 flights from Raleigh-Durham to 44 destinations. Our American Eagle partner operates 49 flights a day to another 16 cities. Despite our growth at Raleigh-Durham, the operations of other carriers have decreased by only nine departures per day. But because of our new services, we now account for 64 percent of the departures at that airport.

Our operations are for the most part supported by connecting passengers, who are neither originating at nor destined to Raleigh-Durham. Indeed, our share of the traffic originating at and destined to Raleigh-Durham, which we call the O and D market, was only 41 percent in 1988.

Now, to say that Raleigh-Durham must become nonconcentrated, however that term is defined, is simply to say that American Airlines must close its hub at that city. I do not know whose interests would be benefited by such a development.

I do know that it would be a cause for great consternation in Raleigh-Durham and result in great economic loss to American and its people. We have more than 3,000 employees in Raleigh-Durham whose jobs depend upon our hub operation.

We have said on many occasions that the marketplace is not a perfect regulator, but it is a much better regulator than any federal agency. The provisions of S. 1741 dealing with hubs would be unworkable in practice and are wholly inconsistent with marketplace economics.

As to passenger facility charges, I have no objection to passenger facility charges so long as the enabling legislation contains adequate safeguards to preclude their use for any purpose other than airport development and so long as such charges are part of a cohesive pattern of taxes and user charges at both the federal and local levels to ensure adequate capital investment in the airports and airways system.

The final subject addressed by the bill is that of slot allocations. The fact that operations are limited at four so-called high density traffic airports by means of a slot requirement exemplifies the monumental failure of the federal government to fulfil its responsibility of developing an airports and airways system capable of handling the growth in air transportation brought about by deregulation.

We are certainly not opposed to the entry of other carriers into slot-controlled airports. But we do not think that the withdrawal of slots from incumbents is an equitable way of achieving that end.

A much better approach, it seems to me, would be to compel the FAA to add one slot per hour at LaGuardia and National, the two airports at which there is unsatisfied demand by new entrants and small incumbents. Such a step would increase total operations at those airports by only about 1½ percent and would meet the needs of new entrants and small incumbent carriers, without disrupting the schedules of other airlines.

Now, if the Federal Aviation Administration insists that these additional operations cannot be accommodated by the air traffic control system, it seems to me that the agency should be required to demonstrate to the Congress why the increased staffing and improved facilities it has been promising us will produce no capacity growth whatever.

With all respect, Mr. Chairman, I am not sure that the proponents of S. 1741 realize the magnitude of the impact this bill would have on our business. We must continually make very large long-term capital investments and very far-reaching human resource allocation decisions based upon assumptions about future conditions.

In most American industries, management proceeds on the assumption that entrepreneurial success will be rewarded. The proponents of this bill seem to be telling us that in the airline industry the worst thing we can do is to be successful.

For a moment I would ask you to put yourself in my shoes and look at these issues from my perspective. Take the CRS question first. About 12 years ago, my associates and I saw a need to replace an antiquated method of publishing schedule and price information with modern computer technology.

We thought this should be done by means of a cooperative effort by the industry. Other carriers did not agree. They were not willing to invest the capital necessary to develop such a system.

Moreover, the CAB told us that an industry joint venture would likely be viewed as anti-competitive. As a result, we decided to go it alone. We invested substantial amounts of money in SABRE and for years we had nothing but losses to show for our efforts.

During that time, I might say, everything was fine. Our competitors, the regulators, and the Congress were perfectly happy while we were losing money hand over fist. But as soon as the system turned a profit, our political and legal problems began.

Suddenly we found ourselves being sued, regulated, and criticized on every front. So we tried to diversify the ownership of the system by selling off half of it to Delta and agreeing to sell further percentages to other interested airlines, retaining just 20 percent for ourselves.

Just a few months ago the Government said no. And now with this legislation we are faced with the prospect of forced divestiture.

The message that I am hearing is that we are free to be innovative, free to risk capital, free to compete, as long as we lose money. If we are successful, the rug is likely to be pulled out from under us.

On a second subject, hubs, I am hearing an echo of the same negative message. When deregulation was being debated, Congress was concerned about service to small and medium-sized communities. The fear was that all carriers would enter markets like New York-Los Angeles and ignore the less dense routes.

That clearly has not happened. Because we and other carriers have created a whole network of hubs, access to the Nation's transportation network for small and medium-sized communities has never been better.

We have increased service alternatives beyond anyone's most optimistic expectations. And again, we are being criticized for succeeding.

We were encouraged by smaller communities to create regional hubs. We violated no federal laws and no federal policy goals in providing this increased service. Now that our hubs have become successful, we are told that the Congress wishes to presume that we have engaged in unfair trade practices.

Again the message is that it is OK to fail, but not to succeed. Is that really, gentlemen, the message you wish to send?

Mr. Chairman, we will abide by whatever rules you set down. If Congress wants to prohibit certain activities, all we ask is that you tell us so before we have invested hundreds of millions of dollars and enormous human resources. However, I hope you will recognize that if we are penalized for developing new and innovative approaches to business problems, our incentive to be innovative will clearly diminish. And that I believe is bad both for our industry and for our country.

Before I turn to your questions, I should like to add just a note. If I was sitting in your chairs I might be inclined to ask, is this not the same guy who has been supporting legislation regarding air carrier takeovers, and now he is telling us the Government ought to stay away from regulation?

And I should like to tell you why I think our position on those two bills is completely consistent. In my view, the public interest is best served by a healthy and vigorously competitive airline industry, one that pays decent wages, responds to consumer demand, and operates state of the art equipment.

The same, I might say, can be said of most U.S. industries. S. 1277, the LBO bill, recognizes that burdening air carriers with excessive debt would seriously jeopardize those goals. I share that view and I have thus supported the legislation.

But I think we would be far better off with a package of modifications to our tax and securities laws which would make excessive debt unattractive in all industries, thus avoiding the need for special airline legislation.

Regulation is also counter to the public interest, and that is the reason I oppose this legislation. This bill would burden air carriers, not with debt but with restrictive regulations, thus weakening, I think, the industry's competitive incentives.

I thank you for the opportunity to share my views and would be happy to seek to answer any questions that I can.

[The statement and questions and answers follow:]

STATEMENT OF ROBERT L. CRANDALL
CHAIRMAN AND PRESIDENT
AMR CORPORATION AND AMERICAN AIRLINES, INC.

Mr. Chairman, I very much appreciate the opportunity to appear before you today to discuss S.1741, a bill intended to enhance competition among airlines.

At the outset let me say that I share the Committee's desire for a fully competitive air transportation system. The competitive environment created by the Airline Deregulation Act of 1978 has not only been good for our nation, it has been beneficial for American Airlines. It gave us a unique opportunity to restructure our route system and to expand into new markets. Thus, while my remarks will be critical of certain aspects of S.1741, and while I disagree vigorously with a number of its provisions, I do not quarrel with the objectives of its authors.

The bill addresses six distinct aspects of the airline business. Some of its provisions are more controversial than others; some raise questions on which individual airlines hold differing views. However, I believe it is fair to say that the bill as a whole seeks to do far more than "fine tune" the air transportation system created by deregulation. If enacted, the bill would have a profound impact on that system, would interfere in a number of important ways with the operation of the marketplace, and would make the disadvantages which U.S. carriers suffer versus their foreign flag counterparts even more serious than they already are!

I also believe that the overall effect of this legislation will be to diminish, not enhance, competition. When we talk about competition in the airline business, we need to be sure we focus on what really counts -- competition in city-pair markets. People do not buy air transportation in bulk; they buy a service from one point to another. It is the number of carriers offering service in each city-pair market that is important to the passenger. The number of carriers and their relative size on a nationwide basis are significant only to the extent that city-pair competition is affected.

In my view, S.1741 would do nothing to enhance competition in city-pair markets. To the contrary, by interfering with the marketplace in various ways, it will lead inevitably to a reduction in the level of city-pair competition. For all these reasons, we believe that enactment of the bill would be a serious mistake.

1. Computer Reservations Systems

The bill contains two provisions relating to computer reservations systems. The first would require that computer reservations systems be made available on a non-discriminatory basis. In this regard, the legislation would simply duplicate existing Department of Transportation rules. Since those rules are operating smoothly and since all U.S. airline computer reservations systems are available today on a non-discriminatory basis, I have no idea what kinds of discrimination the bill seeks to address.

The other CRS provision is a truly extraordinary exercise of legislative power -- the requirement that air carriers divest themselves of their computer reservations systems by early 1991. During the past seven to eight years, computer reservations systems have been the subject of an incredible number of hearings, studies, reports and rulemakings and as a consequence, the systems are already heavily regulated. Today CRS critics make four claims:

. That CRS booking fees are too high;

. That the business is non-competitive;

. That airlines who are CRS vendors enjoy a competitive advantage over airlines that failed to invest in CRS a decade ago; and

. That the systems have been a primary cause for the failure of new entrant air carriers.

All of these criticisms are completely unjustified, and I should like to say a few words about each of them.

Booking Fees. The notion that CRS booking fees are too high simply does not stand up under scrutiny. While all five CRS vendors charge similar fees, that is a pattern consistent with other capital intensive service industries. Our fees are very modest when compared with those of comparable services such as Ticketron and provide good value for our customers. American's profits on its CRS operations are entirely reasonable, considering the enormous amounts of capital we have invested and the substantial entrepreneurial risks we took in doing so. Moreover, some CRS vendors are only marginally profitable at current booking fee levels, and at least one vendor is demonstrably unprofitable.

Would forcing airlines to divest their CRS operations reduce booking fees? The answer is clearly no. Indeed, an increase in booking fees would be a virtual certainty. CRS profits are insufficient by themselves to support the major capital investment which system acquisition would entail and any new investor would certainly have a business plan premised on higher booking fees. Indeed, recent statistics on leveraged acquisitions suggest that substantial price increases are a normal concomitant of the assumption of substantial new debt. Moreover, since the DOT's rules regarding preference apply only to airline owned CRSs, I believe it is a 100% certainty that non-airline vendors would promptly offer to sell preferential listings as a means of increasing CRS profitability. Thus, it seems certain that forced CRS divestiture will be costly to both airlines and consumers and that non-airline owned CRS vendors will offer less favorable terms to all carriers than do today's vendors.

Competition in the CRS Business. The view that competition is lacking in the CRS business has always puzzled me. There are five active CRS vendors. Almost every week SABRE loses some of its accounts to competing vendors, just as competing vendors lose some of their accounts to SABRE. Although SABRE continues to be the largest CRS vendor with a market share of approximately 37%, that fact should hardly be surprising since we pioneered the development of the business and have consistently offered a system that is technically superior to some of the others. This Committee cannot lose sight of the fact that a decade ago American Airlines urged development of a single industry computer reservations system. However, the U.S. Government was unenthusiastic and other airlines were unwilling to participate. Thus, the CRS business evolved in the only way that it could -- with a few airlines taking heavy risks while others elected to stay on the sidelines.

Whatever may happen, you can be sure that the forced divestiture of airline-owned CRSs will not make the CRS business more competitive. In fact, there is an excellent likelihood that there would be fewer CRS vendors than there are today.

The "Halo Effect." Years ago, it was claimed that airline CRS vendors enjoyed a competitive advantage as airlines because of bias in the displays and access to confidential booking data. CRS rules first promulgated by the Civil Aeronautics Board and now administered by the Department of Transportation mandate unbiased displays and equal access to data by all participants. As a result, critics have had to find some other basis for alleging competitive advantage, and now point to the so-called "halo effect" of CRS sponsorship. It is true that we get a premium share of business from travel agents who are SABRE subscribers. However, it is also true that we received a premium share of business from many of those same travel agents before CRS was ever invented. In fact, American's largest share premiums were recorded in the 1960s, years before CRS came on the scene. In our view, the phrase "halo effect" is simply descriptive of good customer relationships, which is, it seems to me, what competition is all about.

Even if American's ownership of SABRE does give it some competitive advantage as an airline, is that a reason for divestiture? Every airline has some competitive strengths, just as every airline has some competitive weaknesses. Many airlines enjoy a much lower cost structure than American because they pay lower wages and offer fewer benefits to employees. Others enjoy a competitive advantage in the form of higher yields because of the less competitive composition of their route systems. This is particularly true in the case of the two carriers who enjoy a phenomenally profitable duopoly across the Pacific by virtue of what amounts to exclusive government franchises. Why then should we be deprived of an advantage we have earned?

Despite the clamor of complaints, there has been little correlation between airline profitability and CRS sponsorship. For many years, USAir and Northwest were among the industry's most profitable carriers, despite their decisions not to invest in CRS operations. Although they subsequently purchased interests in the CRSs developed by other airlines, that action does not appear to have had a material impact on their profitability.

The idea that legislative divestiture of airline-owned CRSs would somehow promote greater competition in the airline business is simply wrong. The only possible result would be to take away from those who developed the systems the rewards of doing so. That would be shabby treatment indeed. To the extent that any airline wants to be a CRS owner, that opportunity is available. If the matter is left to the marketplace, concentration of CRS ownership will diminish over time as interests in existing systems are sold to airlines not now participating in the business. The ownership of PARS and COVIA has already been diffused in this manner, and negotiations are continuing for the sale of interests in SABRE.

Impact of CRS on New Entrants. The notion that computer reservations systems have had an adverse impact on new entrants is the exact opposite of the facts. New entrant airlines typically have limited sales forces and insufficient traffic volumes to justify the expense of maintaining their own city ticket offices. However, because their services are made immediately available through CRSs to travel agents all over the nation -- indeed, all over the world -- they are able to offer their products to the public despite their lack of market identity. Most importantly, new entrants are able to obtain bookings at a cost far below what they would have to pay to create those bookings themselves.

If a travel agent wants to make a booking on a given airline, for example, it can be done in either of two ways. The agent can process the booking through the agency's CRS, in which event the airline pays a $1.85 fee to the CRS vendor. Alternatively, the agent can pick up the telephone and call the airline's own reservations number and process the booking with that carrier's own agent personnel at an average cost to that carrier well in excess of the standard CRS booking fee.

Foreign Flag CRS Ownership. For many years, our government has been insufficiently sensitive to a variety of factors that give foreign flag carriers a competitive advantage over U.S. airlines on international routes. As a result, the U.S. share of international air transportation is not what it should be. It is therefore imperative that this Committee weigh the implications of the fact that foreign flag carriers are investing heavily in computer reservations systems and are forming consortiums to market them to travel agents abroad.

Two of these consortiums have already announced booking fees of about $2.25, more than 20% higher than the standard fee charged by U.S. CRS vendors. Yet, none of the provisions of S.1741 address the CRSs owned by foreign flag carriers.

Assuming for purposes of argument that an airline derives a competitive advantage from ownership of a CRS -- an assumption inherent in this legislation -- then a requirement that U.S. flag carriers divest themselves of their CRSs while foreign flag carriers continue to develop and market them would be patently injurious to the ability of U.S. flag carriers to compete on international routes and contrary to our government's objective of expanding U.S. flag carrier presence abroad. In addition, since CRSs owned by foreign carriers are not governed by U.S. rules, taking away the only opportunity U.S. airlines have to defend themselves against foreign CRS abuses seems contrary to sound international aviation policy.

2. Code-Sharing

American Airlines is on record as believing that code-sharing, in any form, in any market, is a deceptive practice. We have said that code-sharing is calculated to mislead the traveling public into believing that service is "on line" when it is not. Although it brings no benefits to consumers, and therefore should be discontinued, no carrier will abandon the practice unilaterally for competitive reasons.

Notwithstanding our views on code-sharing, we do not believe that legislation banning it is required. We urged DOT to prohibit code-sharing when the practice first began to proliferate. They declined to do so, but are continuing to monitor its domestic and international implications. Eventually, the problems inherent in code-sharing will either be worked out in the marketplace or handled by DOT rules.

Furthermore, although code-sharing today is without any redeeming virtues, circumstances could arise in which code-sharing by U.S. carriers becomes necessary to offset what would otherwise be a foreign flag carrier competitive advantage. In such instances, exemptions can be granted to DOT rules, or the rules themselves could be quickly modified. The difficulties of correcting or modifying a statutory ban are such that we believe legislation is unwise.

3. Authority of the Federal Trade Commission

If Section 411 of the Federal Aviation Act had been repealed as part of airline deregulation, there could be no objection to repeal of the provision in the Federal Trade Commission Act that exempts airlines from FTC jurisdiction. However, since Section 411 was retained in the Federal Aviation Act, and jurisdiction transferred from the CAB to the Department of Transportation, repeal of the FTC exemption would result in identical jurisdiction by both FTC and DOT over unfair competition and deceptive trade practices.

When the final stage of deregulation was about to become effective, American urged the repeal of both the FTC exemption and Section 411. We continue to hold that view today. In our view, airlines should be treated the same as other companies in unregulated industries with respect to unfair competition and deceptive trade practices.

4. Dominant Air Carriers

The provisions of S.1741 concerning what are defined as "concentrated hub airports" and "dominant air carriers," if ever enacted into law, would produce a truly extraordinary upheaval in the route systems of every major and national air carrier. For example, it will probably come as some surprise to the city fathers of Buffalo and Syracuse to find that this bill classifies them as concentrated hub airports and that they must lose some of their services. It certainly comes as a surprise to me to find that American Airlines would be considered a "dominant air carrier" at places such as Charlotte, Detroit, Houston, Memphis and Minneapolis, where we operate relatively few services and are not a significant market participant.

I sense that the intent of the authors of S.1741 in this regard is to convert today's one and two carrier hubs into three or four carrier hubs in which the market shares are about equally divided. Mr. Chairman, that is an impossibility however the legislation may be drafted.

Let me give you an example. In 1987, American opened a new hub at Raleigh/Durham, North Carolina. A new $120 million terminal was constructed at our expense for this purpose. Prior to the opening of the hub, nine carriers operated a total of 84 departures a day at Raleigh/Durham. Piedmont's 25 daily departures constituted a 30% market share. Today, American operates a total of 116 flights a day from Raleigh/Durham to 44 destinations. Our American Eagle partner operates 49 flights a day to another 16 cities. Despite American's growth at Raleigh/Durham, the operations of other carriers have decreased by only nine departures per day. However, because of our new services, we now account for 64% of the departures at the airport. Our operations are, for the most part, supported by connecting passengers who are neither originating at nor destined to Raleigh/Durham. Indeed, our share of the traffic originating at and destined to Raleigh/Durham -- the so-called "O&D market" -- was only 41% in 1988.

To say that Raleigh/Durham must become non-concentrated, however that term is defined, is simply to say that American Airlines must close its hub at that city.

Since there are no other carriers waiting in line to commence service, I do not know whose interests would be benefited by such a development. I do know that it would be a cause for great consternation in Raleigh/Durham and result in great economic loss to American. We have more than 3,000 employees in Raleigh/Durham whose jobs depend upon our hub operations. Raleigh/Durham is only one of numerous air transportation hubs that would have to be dismantled if this bill were to become law.

We have said on many occasions that the marketplace is not a perfect regulator; nevertheless, it is a much better regulator than any federal agency. The provisions of S.1741 dealing with hubs would be unworkable in practice and are wholly inconsistent with marketplace economics.

5. Passenger Facility Charges

The current ban on passenger facility charges, sometimes referred to as "head taxes," was a response to an effort by the city of Philadelphia many years ago to tax passengers at the airport as a means of raising general revenues not dedicated to airport uses. Most airlines have steadfastly opposed passenger facility charges for fear that their availability would be abused.

Personally, I have no philosophical objection to passenger facility charges so long as the enabling legislation contains adequate safeguards to preclude their use for any purpose other than airport development. I do believe, however, that any such charges ought to be part of a cohesive pattern of taxes and user charges at both the federal and local levels to ensure adequate capital investment in the airports and airways system. The airways portion of the federal program will be up for reauthorization next year and that would seem to me an appropriate time to consider the question of how passenger facility charges might interact with federal ticket and waybill taxes.

6. Slot Allocations

The fact that operations are limited at four so-called high density traffic airports by means of a "slot" requirement is a national disgrace. It exemplifies the monumental failure of the federal government to fulfill its responsibility of developing an airports and airways system capable of handling the growth in air transportation brought about by deregulation.

So long as slots are required, all airlines -- not just new entrants and small incumbents -- are adversely affected. American has long wanted to compete in the Washington-New York market, but is prevented from doing so by slot requirements. While we are not opposed to the entry of other carriers into slot-controlled airports, the withdrawal of slots from incumbents is neither an equitable nor an appropriate method of achieving that end. A much better approach would be to compel the FAA to add one slot per hour at LaGuardia and National -- the two airports at which there is unsatisfied demand by new entrants and small incumbents. Such a step would increase total operations at these airports by only about 1.5%. The slots provided in this fashion would appear to be sufficient to meet the needs of new entrant and small incumbent carriers without disrupting the schedules of other airlines.

If the Federal Aviation Administration insists that these additional operations cannot be accommodated, that agency should be required to demonstrate to the Congress why the increased staffing and the improved facilities it has been promising us will produce no growth potential whatsoever!

If American were to lose slots at Washington National or LaGuardia, service to its Nashville or Raleigh/Durham hubs would necessarily be reduced. That service currently consists of three nonstop trips per day, and a loss of one trip per day would result in a 33% reduction in service. Dozens of small and medium size cities that use the Nashville and Raleigh/Durham hubs for access to Washington National and LaGuardia would be adversely affected. These cities include Charleston, Asheville, Little Rock, Baton Rouge, Greenville/Spartanburg, Savannah, Birmingham, Louisville, Evansville Huntsville/Decatur, Jackson and Myrtle Beach. In American's view, it is not sound public policy to cause communities such as these to forfeit their access to LaGuardia and Washington National in order to permit still more service to larger cities such as Phoenix or Las Vegas which already have an abundance of direct and connecting air service to the slot-limited facilities.

I understand that the Department of Transportation is currently preparing a Notice of Proposed Rulemaking dealing with the slots issue. In my view, legislation mandating a withdrawal and transfer by auction of slots at high density traffic airports is both unwarranted and inappropriate.

Conclusion

With all respect, Mr. Chairman, I am not sure that the proponents of S.1741 realize the magnitude of the impact this bill would have on our business. We must continually make very large capital investments and very far reaching human resource allocation decisions based upon assumptions about future conditions. In most American industries, the assumption is that entrepreneurial success will be rewarded. With these proposals, you seem to be telling us that in the airline industry, the worst thing we can do is be successful.

For a moment, try to put yourselves in my shoes and look at three issues from my perspective. First, the CRS question. About 12 years ago my associates and I saw a need to replace an antiquated method of publishing schedule and price information with modern computer technology. We thought this should be done by a means of a cooperative effort by the industry. Other carriers did not agree. They were not willing to invest the capital necessary to develop such a system. Moreover, the CAB told us an industry joint venture would likely be viewed as anticompetitive.

As a result, we decided to take the significant risk of independently developing a computer reservations system. We invested substantial amounts of money in SABRE, and for years we had nothing but losses to show for our effort. During that time everything was fine. Our competitors, the regulators and the Congress were perfectly happy while we were losing money hand over fist. But as soon as the system turned a profit, our political and legal problems began. Suddenly we found ourselves being sued, regulated and criticized on every front.

So we tried to diversify the ownership of the system by selling off half the system to Delta and agreeing to sell further percentages to other interested airlines, retaining only 20% for ourselves. Just a few months ago, the government said no. And now, with this legislation, we are faced with the prospect of forced divestiture of this successful business. The message I hear is that we are free to be innovative, free to risk capital, free to compete, as long as we lose money. If we are successful, the rug is likely to be pulled out from under us.

On a second subject, hubs, I am afraid that what we are hearing is an echo of that same negative message. When deregulation was being debated, Congress was concerned about service to small and medium-sized communities. The fear was that all carriers would enter markets like New

York-Los Angeles and ignore the less dense routes. That clearly has not happened. Because we and other carriers have created a whole network of hubs, access to the nation's transportation network for small and medium-sized communities has never been better.

We have increased service alternatives beyond anyone's most optimistic expectations. Again, however, we are being criticized for succeeding. We were encouraged by smaller communities to form regional hubs. We violated no federal laws or policy goals in providing this increased service. However, now that hubs have become highly successful, we are told that the Congress wishes to presume that we have engaged in unfair trade practices. Again, the message is that it is okay to fail, but not to succeed. Is that really the message you wish to send?

Still a third area in which we feel put upon relates to labor costs. At the time of deregulation, we had one of the highest labor cost structures in the airline business. We knew we had a limited time in which to get them down to competitive levels. One alternative was to demand "give backs" from our unions, a very divisive strategy. We decided instead to embark on a different and, in our view, more imaginative approach. First, we asked our employees to allow us to hire new employees at market rates. Second, we promised existing employees they would not only be allowed to retain their higher pay and benefits but would also receive lifetime job security. Third, we promised to grow the company very rapidly, thus offering our employees both advancement opportunities and job security while simultaneously "averaging down" our unit labor costs.

Now, the Congress seems to be saying that American's growth should be restrained, and that a good chunk of our business ought to be handed over to newly created carriers whose very low labor costs permit them to charge fares that we cannot profitably match unless we revert to a wage and benefit "give back" strategy.

I simply cannot understand why hiring people at the lowest possible rates of pay should be the preferred competitive strategy of this or any other government.

Mr. Chairman, we will abide by whatever rules you set down. If Congress wants to prohibit certain activities, all we ask is that you tell us so before we have invested hundreds of millions of dollars and enormous human resources. However, I hope you will recognize that if we are penalized for developing new and innovative approaches to business problems, our incentive to be innovative will clearly diminish. And that, I believe, is bad for the industry and bad for the productivity of the nation.

QUESTIONS OF SENATOR FORD AND THE ANSWERS THERETO

1. What are the disadvantages you refer to which U.S. carrier suffer versus their foreign flag counterparts? I am concerned about foreign airlines investing in U.S. carriers to the extent of gaining control of the airline. Do you have any views on that?

ANSWER: The disadvantages which U.S. carriers suffer versus their foreign flag counterparts are many and varied. They stem primarily from outmoded bilateral agreements, protectionist attitudes on the part of many governments, and foreign government restrictions on the ability of U.S. flag carriers to "do business" abroad. Let me give you one glaring example.

Many years ago the U.S. negotiated rights for operations between Italy and 12 U.S. cities. That entire package of rights was assigned to two airlines -- TWA and PAA -- which each offer only service between Italy and a single U.S. point -- New York. The remainder of the authority has gone unused. The agreement with the Italians entitles them to "consultation" about the addition of a third carrier. Over three years ago American Airlines requested the right to commence service between Chicago and Milan/Rome, a route on which Alitalia enjoys a monopoly because neither TWA nor PAA are willing to provide service although both are entitled to do so. We have received the necessary authority from the Department of Transportation, but despite three negotiating sessions between U.S. and Italian representatives in the past year, we are still blocked from commencing service.

We have done everything in our power, as a private company, to move this project along. We have talked directly with Italian officials, pointing out the benefits to Italy of increased tourism. We have recruited Lee Iacocoa and others with strong ties to Italy to argue on our behalf, and we have talked to everyone who will listen in the Department of Transportation and the State Department. All of this has been to no avail because Alitalia is happy with its monopoly. The result is that American Airlines has been shut out of Italy and no one seems willing to do anything about it.

As for foreign airlines investing in U.S. carriers, we recently had occasion to express our views to the Department of Transportation in connection with the proposal of British Airways to participate in the UAL buyout. Although that proposal has since been withdrawn, our comments are directly relevant to your question, and a copy of them is enclosed.

2. Whether it be due to a shortage of trained controllers or of runways, capacity is limited at certain airports at certain times. How would you allocate access at those airports?

ANSWER: So long as capacity is limited at certain high density traffic airports, I know of no better way to allocate that limited capacity than by the slot system. Slots should be freely bought and sold because it is only in this manner that they will be put to the most efficient use. As pointed out in my testimony, it is not only new entrants and small incumbents that are disadvantaged by the slot system; American Airlines and other large carriers are severely disadvantaged. Nevertheless, if some special slot allocation to new entrants and small incumbents is to be undertaken, slots should not be withdrawn from carriers now using them. To do so would deprive many medium-sized communities of their service to hub airports since new carriers receiving slots would quite logically wish to use them in the largest possible markets. The only sensible way of allocating slots to new entrants and small incumbents is by a modest increase in the number of slots at those airports where there is unsatisfied demand -- LaGuardia and Washington National. The FAA should be directed to apply whatever resources are required to permit such modest increases without compromising safety.

3. If the number of U.S. air carriers should shrink further due to business failure or mergers, would you still see benefits to the travelling public?

ANSWER: People do not buy air transportation in bulk; they buy a service from one point to another. It is the number of carriers offering service in each city-pair market that is important to the passengers. The number of carriers and their relative size on a nationwide basis are significant only to the extent that city-pair competition is affected. Thus we do not understand why people in the government seem mesmerized by statistics relating to the aggregate market share of the largest four or five or six carriers.

Senator FORD. Thank you, Mr. Crandall.

Senator McCain, as we all find ourselves, needs to be cloned, in two places at the same time. So I am going to ask him to ask the questions first, and Senator Bentsen and I will follow him.

Mr. CRANDALL. Thank you, sir.

Senator FORD. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman, for your courtesy.

Welcome, Mr. Crandall. Let me say at the outset that I know I speak for every member of this committee. We admire the success of American Airlines. We admire the ability of American Airlines to be a growing and viable entity and an important part of this nation's economy.

Very frankly, we do not seek to harm your ability to do business, but what we seek is to allow other entities, either now or in the future, that want to engage in the airline business, a level playing field in which to do so.

Perhaps I could start out by asking you about a quote that was in the Wall Street Journal and in the Business Travel News. In response to the question of why American did not offer discounts to big customers, you were quoted as saying: "Because it would be dumb. The reality is that you will go to Detroit because you have to go to Detroit, whether the fare is $175, $275, or $375."

Frankly, Mr. Crandall, that statement does not seem to reflect a competitive spirit to me. Rather, it seems to reflect, at the least, a monopolistic view. Does this statement reflect your view of competition in the airline industry?

Mr. CRANDALL. Let me answer your question, Senator McCain, this way. The question had nothing to do with competition and everything to do with the price elasticity of different kinds of travel.

Let me start, if I may, with this statement. In the fourth quarter of 1989 relative to the fourth quarter of 1988, American Airlines' fuel prices will rise by $75 million and our ticket prices will rise not at all. That is an absolute formula for going bankrupt. So the notion that airline fares are rising like a rocket is simply wrong.

Now, coming to the explicit quotation that you asked me, the reality is that the elasticity of business travel is virtually zero. That is, the volume of business travel changes very little based on prices.

The volume of pleasure travel changes a great deal. That is the underlying logic of the pricing mechanism in the airline business. It makes no sense to reduce the price of a product whose volume will not increase in response to lower prices. It makes a great deal of sense to reduce the price of a product whose volume will go up if prices go down.

So what we seek to do is to offer discounts on empty seats, to leisure travelers who in other countries fly on charter trips, and thus fill up our airplanes. So it has nothing to do with competition, Senator, and everything to do with pricing methodology.

Senator MCCAIN. Mr. Crandall, recently, along those lines, I am sure you paid attention to this development: One of the major airlines announced that they were going to raise their air fares, but they also quickly added that, unless the other airlines raised their fares too, the fare increase would not be a permanent move.

Mr. CRANDALL. Yes, sir, that is absolutely right.

Senator McCAIN. Does that indicate to you that there are enough airlines competing? Because it seems to me that if there were ten or twelve airlines competing, there would not be that kind of leverage over prices as there is now, with only basically four or five major airlines in America.

Mr. CRANDALL. Senator, it would not make any difference if there were 10 airlines, 12 airlines, or 50 airlines. Every airline is going to match the lowest price in the marketplace, and that has long been——

Senator McCAIN. The statement was not match the lowest price, Mr. Crandall. The statement made by the head of the airline was that they were going to raise their prices and, unless other airlines went along with it, that that would not be permanent.

Mr. CRANDALL. That is exactly the point that I am making to you, that in fact, whether there are eight, ten, twelve, or 50 airlines, unless all of them raise their prices none of them will. And when one of them lowers their prices, all of them will.

That is simply the way airline pricing works. If you want to buy a suit, Senator, of a particular brand, size, and color, it is very difficult for you to find out at what price every store in town is selling that suit.

Senator McCAIN. Unless I do not care what kind of suit it is particularly. If there are lots of tailors then I have a much wider choice. If there are only four or five, obviously it is much easier for those tailors to set one price for the suit.

Mr. CRANDALL. You are perfectly right. The point, however, is that it is very easy for a consumer to find out what price is being charged by every airline on every route everywhere in the world. They need only call any travel agent using any CRS.

Senator McCAIN. That is assuming they have a wide range of options.

Mr. CRANDALL. You will have almost perfect price competition.

In 1978 about 70 percent of all consumers in this country traveled on routes where one or two carriers had 70 percent of the business. Today that percentage is very much lower.

O and D competition, that is origin and destination competition in the United States, is immensely more intense than it was in 1978.

Senator McCAIN. Mr. Crandall, my understanding is that the number of airlines, major airlines, have decreased and the market share of the major airlines has increased significantly.

Mr. CRANDALL. Senator, I would add——

Senator McCAIN. The eight largest airlines had 74 percent of the market in 1983. The eight largest airlines now have 90 percent of the market. After deregulation, 215 airlines of various sizes were started. Today, only 59 have survived.

Numerous markets are dominated by one airline. TWA controls 82 percent of the passenger traffic at St. Louis; U.S. Air controls 91 percent at Charlotte.

A dominant airline at a concentrated hub airport charges an average of 27 percent higher fares than airlines at other, unconcentrated airports.

I do not want to take up too much time of the committee, Mr. Chairman. Let me move into CRS just for a few minutes. And I want to repeat, Mr. Crandall, I am one who admires the success of American Airlines. I do not view this as a bashing of American Airlines or any other airline, for that matter. The goal of the legislation that we have introduced is to provide everyone with a level playing field.

Let me just quote to you from a GAO study. At a hearing that was held before the Committee on Public Works and Transportation back in 1988, the GAO stated, concerning CRSs, "These major vendors believe that their profits are justified by the risks involved in developing their own system. Based on our analysis, we do not agree. When the establishment of CRS was being contemplated in the mid-1970's, only two airlines, United and American, had a sufficiently broad national route structure and a sufficiently large revenue base to make the unilateral development of a CRS worthwhile. We believe"—that is the General Accounting Office—"that the success of United and American in establishing profitable CRS is due to the inherent advantage provided by the route structure awarded them by the CAB."

Do you disagree with that finding?

Mr. CRANDALL. Yes, sir, I disagree wholly and violently. And I think, Senator, that anyone who will look at the facts knows that is wrong.

Let me give you two or three facts against which to set that piece of data. In the first place, in 1976, 1974, and 1975 we, American Airlines, led a study. We invited all the other carriers to join us in developing a joint system. They all declined.

Secondly, in 1978 we invented a procedure within SABRE called Co-host, by which we said to the other airlines: You can join us in selling SABRE and, if in the course of the next several years you sell as few as 1,000 SABRE installations, we will sell you SABRE at cost.

We sold, American Airlines sold, 8,000 SABRE installations. The 14 Co-hosts together sold 773. They could have bought the system.

They could have started the system with us and they declined. They were offered the opportunity to buy the system at cost and they declined.

Last year we once again offered to sell SABRE, this time not at cost but at its market value, and they have declined.

You are not creating a level playing field here, Senator. You are taking away from those who created an advantage the advantage that they rightfully earned, and I do not think that is the right thing for the Senate of the United States to do.

Senator McCAIN. My concern, frankly, is that the airlines that own CRSs take $300 million a year from airlines that do not own CRSs.

Mr. CRANDALL. We charge them a price for the service we deliver, which is dramatically less as a percentage of the ticket price than Ticketron or any of the other kinds of services. We charge a booking fee which is less than it costs them to do the bookings themselves, and in fact we charge them for a system which we created and they declined to participate in.

I think we have created a competitive advantage. I have no quarrel with you there. But I think we created a competitive advantage to which we are entitled, and which is every bit as valid a competitive advantage as a new guy who goes out and hires the cheapest possible people at the cheapest possible labor rates and wants to compete on price.

And I do not think the Congress of the United States ought to say that its preferred—indeed, its only acceptable competitive methodology is low price and low wages.

Senator McCain. Except, Mr. Crandall, that several studies of your abuses of your CRS, including contracts with travel agents which have penalties in them if they cancel, halo effects, manipulating seat availablity——

Mr. Crandall. Senator, you are a businessman——

Senator McCain. These are not my opinions, Mr. Crandall. Those are facts from studies by the Department of Transportation, the GAO, and other agencies that have studied it. Clearly, it is not just the fact that airlines own the CRSs; it is the way that they have been used.

Again, those are not my opinions. Those are facts well-documented by many studies.

Mr. Crandall. Those are not well-documented facts, Senator.

Senator McCain. Those studies are by the General Accounting Office, which has great credibility here in Congress, if not with you.

Mr. Crandall. Let me offer my views, if I may. You are a businessman, Senator. If you were selling automobiles, and if you sold me a $15,000 automobile and if I agree to pay you over a 5-year period for that automobile, and if in the middle of that 5-year period I say to you, Senator, I no longer want the automobile and I am not going to pay you for it, and you have a contract and you enforce the contract against me and force me to pay for the automobile, is that anti-competitive?

That is what we do with our CRS contracts. We sign a contract. We bend nobody's arm, and when they sign a 5-year contract we expect them to honor it. But that is not in any sense anti-competitive.

Senator McCain. Finally, Mr. Chairman. You state, Mr. Crandall, that eliminating the FTC exemption would duplicate DOT authority under section 411. Clearly, you know those are two different functions.

The DOT provision is an administrative hearing instigated by a complaint. The FTC is an independent agency with broad powers, including quasi-judiciary, and rulemaking authority. I think they are fundamentally different powers.

Mr. Crandall. I think on this issue I am agreeing with you, Senator. I would simply say I do not see any reason why we should be subject both to 411 and the FTC. Our view would be let the FTC do the regulation of us and every other competitive business. But I see little justification for subjecting us to dual regulation.

Senator McCain. Thank you. Thank you, Mr. Chairman.

And congratulations, Mr. Crandall, on surviving the latest predatory attempt on your airline.

Mr. Crandall. Well, we are trying, sir. Thank you very much. Thank you for your help in that regard.

Senator FORD. Well, it started on a good note and ended on a good note. He thanked you for coming and congratulated you. So I think it worked out very well.

Mr. CRANDALL. I am not used to such generosity Mr. Chairman.

Senator FORD. But take it when you can get it.

Mr. CRANDALL. Thank you, Senator McCain.

Senator FORD. Senator Danforth.

Senator DANFORTH. I was thinking of starting on a good note by asking you which of the various provisions of the bill do you like the most.

But I am not going to ask you that question.

You said, Mr. Crandall, in answer to one of Senator McCain's questions, that an airline owning a CRS has a competitive advantage. Would you explain to us what that advantage is and how it works?

Mr. CRANDALL. There are various ways in which we measure competitive capability within the airline industry. If you look, you will see that throughout the fifties and sixties and into the seventies American Airlines had what we refer to as a share premium.

That is, over all those years we have managed by a variety of methodologies to persuade, to earn, to get slightly more of the passenger traffic than we offer of the seats. So if we offer 15 percent of the industry's seats, we are fortunate enough to carry 16 percent of the industry's passengers.

When the CRS venture began and over the ten years since, our share premium in the airline industry has never been as high as it was in the early 1960's, before CRS' were ever invented. What we think we have done with CRS and I must say this has not been our view throughout, is to preserve the premium share that we had before it ever started.

We think that had we not had a CRS we probably would have lost it, because if you look at the data we get a premium share in those places where we have automated a travel agent, TWA gets a premium share where it has automated a travel agent, United gets a premium share.

Senator DANFORTH. Could you explain to us how that works? Why would American get a premium share where the SABRE system operates?

Mr. CRANDALL. There are five CRS vendors, Senator. Presumably, when a travel agent chooses a CRS vendor they choose an airline with whom they already have a close cooperative working relationship. That is, the sales people work with them, the airline has a substantial percentage of departures in that part of the country, there are joint promotional programs between the travel agent and the airline.

I assume you are aware, I am sure you are, that the CAB some years ago deregulated commissions. Thus, all of the airlines use incentive commissions of various kinds to influence the booking patterns of travel agents.

So typically you find that the relationship between a travel agent and its CRS vendor is not just a relationship between the agent and a CRS vendor, but a relationship between the agent and the airline, which is really the agent's preferred airline for a whole variety of reasons, including the fact that that airline is the CRS vendor.

So although in the early days——

Senator DANFORTH. It is more than that, though, is it not, Mr. Crandall? You said to Senator McCain that it is a competitive advantage for an airline to own a CRS, and it has been said that there is something called a halo effect. Other than what you are talking about, travel agents saying, for various reasons, we like American, they give us an override for selling more tickets, or whatever, but what is the competitive advantage of owning a CRS? How does it work?

Mr. CRANDALL. That is the point I am making. I think that the competitive advantage, it might be more properly described, I suppose, from a big airline's perspective—in our case, when United started back in 1976, had we not matched them we believe that we would have lost, as a consequence of their being the exclusive CRS vendor, a good deal of that preference share that we had had all through the 1960's.

Senator DANFORTH. Yes, but that is to restate what you have already told me, and I am asking you something that you have not answered. And that is, tell me mechanically how it is that owning a CRS operates as a competitive advantage to American?

Mr. CRANDALL. Mechanically, Senator, that advantage has long since gone away. Let me, if I may——

Senator DANFORTH. Please. I know you are going to go back to 1972 or something. But I want to know today whether there is a competitive advantage. Now it seems you have changed your testimony.

Mr. CRANDALL. No, no.

Senator DANFORTH. Is there or is there not a competitive advantage for an airline owning a CRS?

Mr. CRANDALL. Let me try once again, because I can answer your question only in the context of what that competitive advantage is. You talk about the halo effect. The relationship that we have with a travel agent would be difficult to sustain—if we and travel agent A have a relationship, a multi-faceted relationship, it is based on commissions, it is based on our constant presence in the agency, it is based on joint promotions.

If we were not able to offer that agent a CRS, then it would be very difficult for us to sustain that favorable relationship. Because we can offer a CRS as one of the many services that we provide, we continue to get that preferential share.

It is I think very important, Senator, to look back at the history of CRS.

Senator DANFORTH. I know you want to do that and I do not want to cut you off, except that I do not want to take all the committee's time.

What I want to know is, right now, the year 1989, what is the competitive advantage that you have said exists for American in owning a CRS? And specifically, I'd like for you to describe the halo effect, if you would, and tell us whether there is such a thing, and how that works to the advantage of American?

Mr. CRANDALL. OK. Once again, the halo effect is an attempt to explain what used to be presumed to be the effect of preferential displays, preferential flight displays in the system.

When preferential displays went away, we and other CRS vendors continued to get preferential shares from the people who used our CRS'. So we all said to ourselves, why? And the term "halo 'got invented.

Nobody knows what halo is, but it consists so far as we know, Senator, of the impact of commissions, the impact of sales help, the impact of joint promotions, the impact of the CRS system. All of those things added together add up to halo.

That is, halo is that preference that surrounds the CRS, but which is not linked to the CRS.

Senator DANFORTH. Well, let me ask you this then. Is it not true that the airline that owns the CRS is able to update information in the system more rapidly than other airlines?

Mr. CRANDALL. That is not true, sir.

Senator DANFORTH. That is factually not true?

Mr. CRANDALL. That is factually incorrect.

Senator DANFORTH. Therefore, it is factually incorrect that an airline that owns a CRS can match, meet, or go lower than any fares charged by a competing airline?

Mr. CRANDALL. Factually incorrect.

Senator DANFORTH. And is it also factually incorrect that last seat availability is not something that can be made known by the owning airline to the travel agent?

Mr. CRANDALL. That is factually incorrect. Senator, I can say this to you absolutely, and I can prove it to you or anybody else that wants to come and spend the two or three or four or five days required: There is zero difference in every respect with regard to the mechanical aspects of CRS between the owning airline and any other airline, absolutely zero.

Senator DANFORTH. But to say the least, it would be a competitive advantage to have your competitors transfer $300 million to the airlines that own CRS's?

Mr. CRANDALL. But in fact, Senator, they are not transferring money. They are paying for a service on a system that we created, that we offered them the opportunity to share in creating, that we offered them the opportunity to buy.

They are not transferring money. They are paying for a service.

Senator DANFORTH. Are they not writing out a check?

Mr. CRANDALL. Yes, but they are not transferring money, Senator.

Senator DANFORTH. It is writing a check without transferring money?

Mr. CRANDALL. Well, they are paying for a service.

Senator DANFORTH. All right. I call that transferring money.

Mr. CRANDALL. Well, okay. But you would surely agree that if— let us take two airlines, one repairs the other's airplanes. You are also transferring money from carrier A to carrier B in exchange for maintenance services rendered.

All that is happening with CRS is money is being paid for a service. We have offered and we offer today to any airline that wants to be a seller as well as a buyer can come in and buy SABRE. It is for sale. The price is posted.

We sold it to Delta. The Government said, we will not let you sell it to Delta. We said, OK, we will sell it to any airline without exception. Any domestic airline that wants to come in can buy SABRE at the posted price. And nobody has appeared at the door.

So it cannot be that important, Senator, because if they want it it is there for them to buy.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. We have been joined by the distinguished Senator from Texas, Senator Bentsen. Senator.

Senator BENTSEN. Thank you very much, Mr. Chairman.

I am delighted to have Mr. Crandall here. I think I show some bias in that I think he is one of the most able managers in the business, and he is a man highly respected even by those who violently disagree with him from time to time. And there have been some times I have disagreed with him.

But when we talk about deregulation, deregulation can be carried to an extreme, and that is what we have to watch. I look at what happened to the S and L industry. That was a case where we went too far on deregulation, and in every industry you are going to find a few goats who take advantage of a situation where you do not have some kind of surveillance to protect the public interest.

And that happened there, and it cost us an incredible amount of money, the taxpayers. And the question there was the safety of depositors.

When it comes to airlines, I think the overriding concern in the public interest is the safety of that airline. That is why I have supported, Mr. Chairman, your legislation, that we have to have an overview on these LBO's.

It seems to me, as one who was once a businessman in the private sector, that an airline can become a great cash cow if you do not buy new airplanes. So you go in and you leverage it up and then you do not buy any more aircraft, and if you have any optional maintenance matters you stretch those out, to try to service that debt.

So someone has to be there to be the judge who is objective, does not have an axe to grind, but representing the public and to see that safety is ensured. And that is why I think that we have to move on your piece of legislation.

The other side of the coin, and it gives me some concern as I think about competition, and that is the concentration that is taking place in hubs. Mr. Crandall, I can understand why there is little elasticity in the business traveler and there is in the leisure traveler, and I can understand why you do your tickets that way.

But I would also think that there is a matter of discretion on the part of the business traveler if there is competition that has a lower price. If you get into a hub where you have no competition, you can pretty well demand your price.

But if you do have competition, you are going to have to lower your price to whatever your major competitor is. And that is a concern of mine on the hub system. And yet I know it is a more efficient way to exchange passengers.

Mr. CRANDALL. Senator, could I say——

Senator **Bentsen**. You want to tell me about it?

Mr. **Crandall**. Could I say a word on that, because I think it is terribly important for everybody to understand that the notion of non-competitive hubs is simply imaginary. Let me give you an example of that, Dallas-Fort Worth. People who live in hub cities have an enormous number of competitive options.

Let me take as an example the city pair Dallas-Fort Worth to Boston. Between Dallas-Fort Worth and Boston on a non-stop basis, only two carriers compete, Delta and American. But between Dallas-Fort Worth and Boston by way of other hubs, many carriers compete.

You can go from Dallas-Fort Worth to Boston by way of Midway, on Midway Airlines by way of Midway. You can go from Dallas-Fort Worth to Boston by way of O'Hare on United. You can go from Dallas-Fort Worth to Boston by way of Minneapolis on Northwest. You can go from Dallas-Fort Worth to Boston by way of U.S. Air over Pittsburgh.

Senator **Bentsen**. Are you trying to compare a non-stop to——

Mr. **Crandall**. What I am saying, Senator, is this: that for example, our prices to Boston were, until 4 or 5 weeks ago, substantially higher than those of a number of carriers who were offering service by way of alternative hubs. The load factors on our non-stop flights between D-FW and Boston declined rather sharply.

We went into the market. We said, what is happening, and we found that 40 or 50 percent of the people were choosing the low-priced alternative of going from Dallas-Fort Worth to some other hub and then to Boston.

So the important thing I think that people are not focusing on is that people who live in hub cities have more alternatives than those who live in non-hub cities. Let us compare a person who lives in Wichita with a person who lives in Dallas-Fort Worth. The citizen of Wichita has good service by way of many hubs to wherever he would like to go, but the citizen of Wichita has no non-stop options except to the hubs with which Wichita is connected.

The citizens of a hub city, on the other hand, have an enormous range of choices. They have non-stop services to many places. For example, Senator, from Dallas-Fort Worth we provide non-stop service to some 90 destinations. And in addition, the citizens of that hub city have the option of traveling to those same destinations by means of other hubs, and that is where the price discipline comes in.

Senator **Bentsen**. Mr. Crandall, I question very seriously that to be able to go by another hub to an ultimate destination is a major competitive force to a non-stop, to go a route that I have a 50-percent increase in the chance of losing my luggage, or a 50-percent increase in being left out on a runway while they tell me that they have a problem that they did not know at the time they left the gate.

I tell you this, Mr. Crandall. I would pay a pretty good margin extra to get that non-stop. And when you do not have the competition there, that is a concern to me. I do not know what to do about it, because I am a great supporter of the competitive forces of the private sector.

Mr. CRANDALL. Well, I would only say to you what I have described to you is a very effective method of origin and destination, the origin and destination being D-FW and Boston. There is a great deal of competition on most origin and destination city pairs.

I can only say to you gentlemen that, if the notion is, if your collective notion is, that it would be nice to have three or four competitors non-stop between D-FW and Boston, that is an unattainable objective. It cannot happen because the economics of such a system will simply defeat it. Nobody will put private capital into doing that.

You can demonstrate that, Senator, by going back and looking at the CAB. I would remind you that it was not the airlines who called for deregulation. It was the Congress which said, look what has happened under regulation. We have had 40 years of regulation. The airlines are regulated on their prices, they are regulated on their service levels, they are regulated on their rate of return, and what has happened? The airlines have become slothful and they are not very creative; the airline industry is heavily unionized; its people are paid at well above market rates; and so let us deregulate it.

And it was deregulated, and in fact what has resulted is a system which the Brookings Institution has said has saved consumers $10 billion a year and which offers, Senator—but I take your point, which is a good one—many ways to get from D-FW to Boston and a great deal of price competition on every O and D route.

Gentlemen, if you really want a more competitive airline industry, what you must do is compel every level of government to build more facilities. We will compete more vigorously. The thing that holds us back from competing is the unavailability of facilities.

We cannot fly, for example—my airline would love to compete with Trump and Pan Am between Washington and New York. We cannot. We would love to compete more intensively in Chicago. We cannot.

Senator BENTSEN. Well, I tell you, Mr. Crandall. I strongly agree with that point, and what we have not done in the way of adding to facilities and updating our navigational aids I think is derelict and threatens the infrastructure of the country.

I see that happening. And I wish the new Mayor of New York well, but I look at what has happened to that city. But in turn we are doing it across the country when we are talking about bridges, when we are talking about airports and navigational aids.

I look at them buying buses in New York City that have the specifications for buses for Third World countries, because of the condition of the streets. Some kind of an investment has to be made.

Mr. CRANDALL. That is the underlying limitation Senator, intensified competition in the airline industry depends on the availability of facilities. If the Government makes facilities available and lifts the restraints on competition which the absence of facilities creates, then I think you will continue to have the kind of vigorous competition in the airline business that you have today.

But I do not think you will do so by taking away our ability to compete in the various ways in which we have competed.

Senator BENTSEN. Thank you very much, Mr. Chairman.

Senator FORD. Thank you, Senator.

Mr. Crandall, I am going to forego my questions. I think most of them have been answered, and you have answered most of them to my satisfaction.

You made one statement about, I believe it was, Raleigh-Durham, where it cost you $127 million to make that a hub. Now, did that just expand the facilities that were already there?

You use the facilities that you spent the $127 million for, and then you just said the Government makes facilities available. They make it available outside the terminal, but not the terminal.

What I am concerned about is, at that airport we have a large expenditure by the airlines. We find at most airports that airlines are taxed and fees paid or contracts signed, and they do that because they think it is going to be good business. But the airport then goes to the bank based on that contract.

Now, of the $127 million, what kind of help did you get from the local facility or local people to offset or to pay for some of it?

Mr. CRANDALL. The $120 million that I referred to, Senator, we went to Raleigh-Durham and we built a new terminal, and it was built. In order to build it, we had to borrow $120 million.

That borrowing was done by a public body. But the bonds are guaranteed by American Airlines, so they are in every respect an American Airlines undertaking.

I would say to you, Mr. Chairman and Senator Danforth, finding the money to build facilities is not a problem. The airlines will build the facilities. What we need from the Government is air traffic control capability, which we cannot provide; and we need an effective method of resolving disputes between environmentalists and those who want to create incremental capacity.

It is virtually impossible in this country to build a new runway, and one of the reasons is that the Federal Government has failed to play an active role in resolving such disputes. Hence, for example, in Chicago there is very little hope that we will build any new runways in my lifetime. And the consequence is that delays—you are going to do one of two things or both in Chicago. You will have slots and you will have delays.

But that is the principal constraint on competition.

Senator FORD. I am still frustrated by the restriction of the airport improvement trust fund, now with a balance of $7 billion. We cannot get to it in order to accommodate those things that are necessary, yes the tax is collected specifically for that and put into a trust fund.

It is my understanding that last fiscal year we had 163, I think, trust funds in the Federal Government, and those 163 trust funds collected 53 percent of the money in the general fund.

Now, you talk about smoke and mirrors on the budget. Of course, social security, highway trust fund, airport improvement are the three majors, and if they come off the budget we will see a $200 billion shortfall annually, rather than what we are monkeying around with now.

Mr. Crandall, I am not going to keep you any longer. I thank you for your testimony today, thank you for your candor and your offer to work with us.

Mr. CRANDALL. Thank you, Mr. Chairman.

Senator FORD. And I assure you that we will. Thank you very much.

Mr. CRANDALL. Thank you very much. Thank you, Senator Danforth.

Senator FORD. Next is Edward Beauvais, president, America West Airlines, from Phoenix, AR. And I hope your Senator will be back shortly. He said he would be. But Ed, you go ahead and proceed.

You have got a long document here with a lot of attachments to it, and we will include then in the Committee files.

STATEMENT OF EDWARD R. BEAUVAIS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, AMERICA WEST AIRLINES, INC.

Mr. BEAUVAIS. Thank you, Mr. Chairman. I have a brief statement that I would like to read that summarizes.

Senator FORD. You certainly may, and I want you to proceed.

Mr. BEAUVAIS. Mr. Chairman, I am Edward R. Beauvais, chairman and chief executive, America West Airlines, a post-deregulation airline that began operations a little over 6 years ago.

The subcommittee is to be commended for conducting this important hearing and we very much appreciate the opportunity to testify today on the subject of increased competition among commercial air carriers at the major airports in the United States, and in particular provisions of S. 1741.

America West has been extremely concerned about the increased level of concentration in the domestic airline industry today, concentration that has come about largely as a result of mergers and acquisitions approved by the Department of Transportation during the period 1985 to 1988, when DOT had all but effectively abandoned jurisdiction over such transactions.

We fully support the ongoing efforts of the members of this subcommittee, the General Accounting Office, and the Department of Transportation in studying the consequences of such concentration upon competition and, more importantly, upon the traveling public. And we see today's hearings as an important first step in determining what needs to be done to assure that a competitive environment for providing air transportation exists.

While it may in one sense be too late to undo many of what we at America West believe were misguided policy decisions during the 1985 to 1988 period by the Department of Transportation, we applaud the efforts of Senators Danforth, McCain, Bond, and Pressler in co-sponsoring S. 1741, which sets forth several measures that are designed to increase and ensure competition among commercial air carriers at the nation's airports.

In reviewing the elements of S. 1741, we were gratified to see that many of these issues were specifically addressed, including: the divestiture of the computer reservation systems; the recognition of the continuing need to assure that such systems, once divested from their present airline owners, are made available on a nondiscriminatory basis; the prohibition of code-sharing; the involvement of the Federal Trade Commission in airline competitive matters on a comparable basis as with other industries; the creation of statutory presumptions regarding unfair competitive practices at concentrated airports; the granting of specific statutory authority to the Washington of Transportation to seek injunctive relief with respect to unfair and deceptive practices of competition in the air transportation industry, and finally; the establishment of a new mechanism for the allocation of slots at high-density airports.

But we have certain technical suggestions with respect to the present language in the bill. This legislation as presently drafted goes a long way toward establishing a comprehensive and effective program for increasing competition among air carriers.

We would urge, however, that the subcommittee in its consideration of this bill include additional provisions addressing the important competitive problems raised by the frequent flyer programs, travel agent commission override programs, and the indefensible Wright amendment, which has severely and unnecessarily restricted competition at Love Field in Dallas, TX.

Turning initially to the frequent flyer programs, these programs, although quite popular, are among the most antithetical to the spirit and the goals of airline deregulation. These programs operate to lock consumers into an airline, effectively making it more costly for passengers to switch carriers in response to fare differences.

This in turn lowers the cross-elasticity of demand among airlines, making their products poorer substitutes for one another. And as such, frequent flyer programs clearly act as a device facilitating avoidance of competition on price and other terms, by lowering the ability of the new entrant carriers to attract customers even with deep discount fares.

The programs do not promote new business. They simply allow airlines to charge higher prices for the business that they already are receiving.

In the process, they also increase the difficulty that any entrant will face in trying to establish itself in a new market.

While there are obviously a variety of ways to address the effects of frequent flyer programs, we would urge the subcommittee require as a first step that the Internal Revenue Service conduct an expeditious rulemaking proceeding to evaluate the proper taxation of the benefits provided by the programs to the frequent flyer members.

Insofar as travel agent commission override programs are concerned, these overrides are typically paid to travel agents on the basis of revenue generated above a specified minimum level in a given period. And equally typically, the megacarrier that is paying such a commission to the agent has already installed a computer reservation system in that agency.

Thus, it is no wonder that these carriers are able to achieve and maintain higher enplanement shares than their service offerings would warrant in cities where these systems and payment programs are in place, and that it is particularly difficult for new carriers without such market power to enter these markets.

At a minimum, the traveling public should be informed that the agent is eligible for such override commissions and from which carrier, and we would urge the subcommittee to go one step further and consider the merit of imposing a cap on the amount of commissions that could be paid to travel agents for domestic air transportation.

Then finally, we would urge most strongly that all geographic restrictions be removed on the service provided at Love Field in Dallas, Texas. The so-called Wright amendment, which was enacted to assure that the airlines would move their operations to the Dallas-Fort Worth Airport, is a terribly anti-competitive provision that no longer serves any, much less a useful, purpose.

The Dallas-Fort Worth Airport has long been a huge success, and indeed is undergoing significant expansion at this time. On the other hand, because of the Wright amendment limitations, Love Field service has become monopolistic and accordingly suffers from no competition and unreasonably high fares.

To the extent that the Dallas City Council is concerned about aircraft noise at Love Field because of competitive operations, all they need to do is to conduct a noise study and enact an appropriate noise ordinance evenhandedly applied to all operators, to address any noise problems identified in the study.

In summary, S. 1741 addresses many of the impediments to a more fully competitive air transportation system and, with the addition of provisions relating to frequent flyer and travel agent commission override programs, as well as Love Field access, the bill will without doubt increase competition among air carriers throughout the United States.

We appreciate the opportunity to testify today on the future course of airline competition in the United States, and I would be pleased to answer any questions that you or any members of the subcommittee may have.

Thank you very much.

[The statement and questions and answers follow:]

STATEMENT OF
EDWARD R. BEAUVAIS
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
AMERICA WEST AIRLINES, INC.

Mr. Chairman and Members of the Subcommittee, I am Edward R. Beauvais, Chairman and Chief Executive Officer of America West Airlines, Inc., a post-deregulation airline that began operations a little over six years ago. The Subcommittee is to be commended for conducting these important hearings, and we very much appreciate the opportunity to testify today on the subject of increased competition among commercial air carriers at the major airports in the United States and, in particular, on the provisions of S. 1741.

Background of America West Airlines, Inc.

By way of background, America West is one of the two remaining post-deregulation carriers. We began operations as a new entrant airline in August 1983 with three Boeing 737-200 aircraft operating to and from our Phoenix hub and the cities of Los Angeles, Kansas City, Colorado Springs and Wichita.

Since that time, we have grown dramatically. America West now operates a fleet of 79 aircraft: 64 Boeing 737s, eight Boeing 757s, and seven deHavilland Dash 8s. The number of cities we serve has increased from three to fifty, and our operations now extend across the United States and into Canada. On November 16, 1989, America West will further expand its national presence with the inauguration of Boeing 747 service to Honolulu from both our hubs in Phoenix and Las Vegas.

This phenomenal growth has brought America West to the point where we now provide service to more than 13 million customers annually. In the process of expanding our operation, we have created more than 10,000 jobs held by people who own stock in our company and participate in our employee profit-sharing plan.

Increased Concentration And Its Effects On Competition In The Domestic Airline Industry

America West has been extremely concerned about the increased level of concentration in the domestic airline industry today, concentration that has come about largely as a result of the mergers and acquisitions approved by the Department of Transportation during the period 1985 through 1988, when the D.O.T. had all but effectively abandoned jurisdiction over such transactions. Indeed, as may be seen from the attached tables that were published in the Aviation Daily on October 20, 1989, the six largest U.S. carriers, American, United, Delta, Northwest, Continental and TWA, accounted for 76.98% of the system revenue passenger miles and 76.14% of the available seat miles in the first nine months of 1989 compared to 72.51% and 72.61%, respectively, for the same period in 1988.

We fully support the ongoing efforts of the members of this Subcommittee, the General Accounting Office and the Department of Transportation in studying the consequences of such concentration upon competition and, more importantly, upon the traveling public, and we see today's hearings as an important first step in determining what needs to be done to assure that a competitive environment for providing air transportation exists.[1] While it may, in one sense, be "too late" to undo many of what, we at America West believe, were misguided policy decisions made during the 1985-88 period by the Department of Transportation, we applaud the efforts of Senators Danforth, McCain, Bond and Pressler in co-sponsoring S. 1741, which sets forth several measures that are designed to increase and ensure competition among commercial air carriers at the nation's major airports.

Specific Comments on S. 1741

When I last testified before this committee on the subject of airline deregulation in 1987, I indicated that, from the standpoint of a carrier such as America West which was seeking to expand the scope of its operations, the most serious of the competitive impediments to its future growth and entry into new markets included (1) airport access issues, including slots and terminal facilities, (2) abuse of computer reservation systems,

---

[1] We would also point out that Michael Levine, one of the early proponents of airline deregulation, has written an extensive article discussing the workings of airline markets since deregulation entitled, "Airline Competition in Deregulation Markets: Theory, Firm Strategy, and Public Policy," 4 Yale J. on Regulation 393 (1987) in which he recognized the failure of the theory of contestability in the airline industry. In addition, Professor Severin Borenstein, America West's witness in the U.S.Air-Piedmont Acquisition Proceeding, has written two articles (which are attached for the convenience of the Subcommittee) examining airport dominance and market power in the U.S. airline industry and the competitive advantages of dominant airlines.

(3) travel agent commission overrides, (4) frequent flyer programs, and (5) inadequacies of the existing air traffic control system (which is beyond the scope of today's hearing). Two years later, these impediments remain as the most serious threats to a competitive air transport system in the United States.

In reviewing the elements of S. 1741, we were gratified to see that many of these issues were specifically addressed, including:

-- the divestiture of computer reservation systems;

-- the recognition of the continuing need to assure that such systems, once divested from their present airline owners, are made available on a non-discriminatory basis;

-- the prohibition of code-sharing;

-- the involvement of the Federal Trade Commission in airline competitive matters on a comparable basis as with other industries;

-- the creation of statutory presumptions regarding unfair competitive practices at concentrated airports;

-- the granting of specific statutory authority to the Secretary of Transportation to seek injunctive relief with respect to unfair or deceptive practices or unfair methods of competition in air transportation; and

-- the establishment of a new mechanism for the allocation of slots at the high-density airports.

Additional Provisions Needed in S. 1741

While we have certain technical suggestions with respect to the present language in the bill,[2] this legislation, as presently drafted, goes a long way towards establishing a comprehensive and effective program for increasing competition among air carriers. We would urge, however, that the Subcommittee, in its consideration of this bill, include additional provisions addressing the important competitive problems raised by frequent flyer programs, travel agent commission override programs, and the indefensible Wright Amendment that has severely and unnecessarily restricted competition at Love Field in Dallas, Texas.

---

[2] For example, the prohibition on the ownership, operation or control of a computer reservation system applies, as presently drafted, to air carriers or their affiliates but not to foreign air carriers, which, in our view, should also be included in the prohibition, insofar as sales for transportation to, from or within the United States are concerned.

Turning initially to frequent flyer programs, these programs, although quite popular, are among the most antithetical to the spirit and goals of airline deregulation. As Mr. Richard James, Piedmont's Vice President of Planning, testified in the USAir-Piedmont Acquisition Proceeding, "No event in this industry has done more to create brand loyalty than frequent flyer programs." These programs operate to "lock" consumers into an airline, effectively making it more costly for passengers to switch carriers in response to fare differences. This, in turn, lowers the cross-elasticity of demand among airlines, making their products poorer substitutes for one another. And, as such, frequent flyer programs clearly act as a device facilitating avoidance of competition on price and other terms by lowering the ability of new entrant carriers to attract customers even with deep-discount fares. The programs were originally aimed at business travelers, which are recognized to be the least price-sensitive segment of airline demand. The programs do not promote new business, they simply allow airlines to charge higher prices for the business that they are already receiving. In the procress, they also increase the difficulty that any entrant will face in trying to establish itself in a new market. While there are obviously a variety of ways to address the effects of frequent flyer programs, we would urge that the Subcommittee require, as a first step, that the Internal Revenue Service conduct an expeditious rulemaking proceeding to evaluate the proper taxation of the benefits provided by these programs to frequent flyer members.

Insofar as travel agent commission override programs are concerned, these overrides are typically paid to travel agents on the basis of revenue generated above a specified minimum level in a given period, and, equally typically, the megacarrier that is paying such a commission to the agent has already installed its computer reservation system in that agency. Thus, it is no wonder that these carriers are able to achieve and maintain higher enplanement shares than their service offerings would warrant in cities where these systems and payment programs are in place, and that it is particularly difficult for new carriers without such market power to enter these markets. At a minimum, the traveling public should be informed that the agent is eligible for such override commissions and from which carrier, and we would urge the Subcommittee to go one step further and consider the merit of imposing a cap on the amount of commissions that could be paid to travel agents for domestic air transportation.

Finally, we would urge most strongly that all geographic restrictions be removed on the service provided at Love Field in Dallas, Texas. The so-called Wright

Amendment, which was enacted to assure that the airlines would move their operations to the Dallas/Ft. Worth airport, is a terribly anti-competitive provision that no longer serves any, much less a useful, purpose. The Dallas/Ft. Worth airport has been a huge success, and, indeed, is undergoing significant expansion at this time. On the other hand, because of the Wright Amendment limitations, Love Field service has become monopolistic and, accordingly, suffers from no competition and unreasonably high fares. To the extent that the Dallas City Council is concerned about aircraft noise at Love Field because of competitive operations, all they need do is to conduct a noise study and enact an appropriate noise ordinance even-handedly applied to all operators to address any noise problems identified in the study.

In summary, S. 1741 addresses many of the impediments to a more fully competitive air transportation system, and, with the addition of provisions relating to frequent flyer and travel agent commission override programs as well as Love Field access, the bill will, without doubt, increase competition among air carriers throughout the United States.

Mr. Chairman, we appreciate this opportunity to testify today on the future course of airline competition in the United States, and I will be pleased to respond to any questions that you or the other members of the Subcommittee might have.

QUESTIONS OF SENATOR FORD AND THE ANSWERS THERETO

1. Some would argue that involving the FTC in the airline industry would create dual jurisdiction with the Department of Transportation. How do you see the two roles or jurisdictions working?

Response: While there are those who may argue that involving the FTC in the airline industry would interfere with the responsibilities of the Transportation Department, it is possible to envision a cooperative relationship in which the Transportation Department focuses on airline issues within its particular areas of expertise and the Federal Trade Commission would focus on specified issues with which it may have greater expertise. Thus, for example, the FTC has been given responsibility for a wide variety of consumer protection issues involving the rest of our nation's economy and this expertise may prove helpful in addressing airline consumer protection problems. We would point out that the Transportation Department and the Environmental Protection Agency have entered into a cooperative working agreement concerning the transportation of hazardous wastes pursuant to which the responsibility of the Transportation Department is for the transportation safety issues and the focus of the EPA is upon the environmental consequences of such transportation, indicating that such cooperative relationships, with each agency bringing its expertise to bear on a particular issue, can be effective in addressing problems that have wide-ranging effects. We would also note that, under the Hart-Scott-Rodino Act, the FTC and the Department of Justice have developed a cooperative working relationship concerning matters within the purview of that statute over which they have dual jurisdiction.

2. Why shouldn't airlines be allowed to foster "brand loyalty" through frequent flyer programs? Are all competitive advantages bad or unfair?

Response: Of course, airlines should be allowed to foster brand loyalty and certainly all competitive advantages are neither bad nor unfair. Such activities can be carried to a point, however, that negatively affects competition and the consumer. In passing airline deregulation legislation, the Congress determined that it was in the public interest to encourage a substantial number of airlines, operating in what was thought would be an open marketplace, to provide the nation's air transportation system. Unfortunately, the merger and acquisition policies pursued by the Department of Transportation over the period 1985-87 have resulted in a more highly-concentrated airline industry than was the case prior to deregulation, with only three carriers, American, United and Delta, controlling more than half of the domestic market. And, while the so-called "contestability theory" was believed to provide a valid basis for permitting those mergers, the work of Michael Levine, Severin Borenstein and, most recently, the G.A.O., have thoroughly discredited that theory. Indeed, what these studies have shown is that there are, in fact, several impediments to entry, including frequent flyer programs, airport access issues, travel agent commission override programs, ownership of computer reservation systems by airline competitors and fortress hubs that permit the larger carriers to "control" traffic and increase fares. Consequently, if the Congress desires to take the steps necessary to address increased concentration, higher fares, and poorer quality of service, it must address these impediments to entry that permit carriers to behave in this manner. While America West is aware that these larger carriers argue that addressing these matters is "unfair" and we fully recognize that it will not be politically easy to take on these issues, the fact of the matter is that, if the Subcommittee desires to address the problems of airline deregulation, it cannot avoid addressing these issues if it wants to avoid the more expansive reregulation legislation that has been suggested by some.

3. Your testimony mentions competitive impediments to airport access, including slots and terminal facilities. Could you elaborate on what impediments exist to access to terminal facilities.

Response: If airline deregulation is to be successful, airlines must be able to initiate and/or expand service at an airport at a level and in a manner that is competitive. At many airports, such as St. Louis, Minneapolis and San Francisco, it is, quite simply, difficult to obtain any, much less sufficient, gates and other terminal space at appropriate times to be able to mount an effective and competitive operation. Included among the impediments to entry at airports are gates and other facilities such as ticket counter space, office space, access to the baggage systems and the like. And, while it may be possible to gain access to such facilities, the high charges imposed by the carriers that, in effect, "control" such space and the times of the day that such "access" is made available are "costs" that make effective competition difficult and discourage a carrier from entering a particular airport. One example of such a "cost" which is ultimately absorbed by the passengers is the cost of a "turn" (i.e., the handling by another carrier of an America West arrival and departure) at an airport where America West does not have its own facilities. If one assumes that the average cost for a turn at an airport is $200 (which is America West's estimated cost when it performs these services itself) and that the cost at an airport where access is limited can be $650 (which is what America West actually pays at one capacity-controlled airport), the additional $450 must ultimately be recovered from the passengers on these flights. Thus, if one assumes a 60% load factor on an America West 143-seat 737-300, the cost per passenger of that $450 premium is $2.62 -- not an insignificant sum when the average price of a ticket on America West's system is only $66.61.

4. The bill proposes withdrawal and reallocation by auction of slots at the four high density airports. How would you provide accommodations for new entrants? How frequently would you suggest reallocation of slots?

Response: America West has demonstrated on several occasions the manner in which the existing buy/sell program has precluded new entry at the high density airports, and, indeed, the Congress has mandated that the Transportation Department conduct a rulemaking proceeding on this subject, a proceeding that the Department has not yet finalized. During the course of these regulatory proceedings and in Congressional testimony, America West has urged that a reallocation lottery be held annually to permit new entrants to begin operations at the high density airports. The mechanism for such a withdrawal lottery is in place, and its implementation would be relatively simple. Thus, the F.A.A. would determine the number of slots that were to be allocated, withdraw them on the basis of the numbers that have already been assigned by the F.A.A. to these slots for the purpose of withdrawal, and then conduct a lottery to establish the order in which the new entrants would select these slots. As the Subcommittee is aware, there are only a few "new entrant" air carriers remaining, and, if the new entrants are required to operate and not otherwise dispose of the slots for a significant period of time, the total number of slots to be allocated in this manner would be a small number.

Senator FORD. Thank you very much, Mr. Beauvais.

I will call on Senator Danforth for his questions.

Senator DANFORTH. Mr. Chairman, thank you very much.

You were here in the room when Mr. Crandall testified about the competitive advantage of the CRS system and then, when asked further about it, his apparent view was that it was more or less a carryover from the past; and the halo effect was more historical than real today; and that there was no advantage with respect to operating the system and putting in information relating to seat availability; or undercutting competition by having more rapid access to the system.

Was he correct in that? Have we overstated the relationship between owning a CRS system and anti-competitive practices?

Mr. BEAUVAIS. No, I strongly disagree with Mr. Crandall on these issues. I agree with the fact that he has indicated that there is a competitive advantage to a CRS carrier-owner.

Senator DANFORTH. How does it work?

Mr. BEAUVAIS. It is the technology that exists in the travel agent, along with the incentives that they have working with that technology. In essence, what I think the CRS system does is it sacrifices the individual integrity of that travel agent. It captures them as a captive customer of the CRS supplier and, through the mechanical operation of the facility itself and the economic incentives that are in place, it creates a condition where there is a significant market share booking on the CRS carrier-owner-supplier from that agency.

Senator DANFORTH. You do not think it is just historical, as Mr. Crandall said, the travel agent who hooks up with, say, SABRE has a predisposition toward American?

Does it have to do with the ability of the owning airline to update information?

Mr. BEAUVAIS. That is part of it, that is part of it. I have to add that if I were in Mr. Crandall's shoes I would be agreeing with Mr. Crandall's comments.

The issue here is how you look at it, and I think you have to put yourself in a position where you are hearing from the airline industry and we all have a major mission as far as we are concerned, and that is surviving in today's environment.

Mr. Crandall finds that as a strategic advantage, which I would if I were him. I find it as a strategic disadvantage. It is a major uphill struggle for us to be a competitor. I do not think it is any accident that most new entrants that apparently had the advantage of lower wages and lower costs have not made it in our industry.

Senator DANFORTH. Do you think that owning a CRS is a major advantage, or a minor advantage? How would you classify it?

You are talking to people here who are not in the airline business. How would you describe it to those of us who are not really all that knowledgeable about the industry on a day by day basis, but are trying to learn? What is wrong with an airline owning a CRS system? Why is it advantageous—not just the cost overrides or the fare override system—but the ownership per se of the CRS?

How does that work to the advantage of American and to the disadvantage of America West?

Mr. **Beauvais**. Well, number one, it is a major advantage. It is a major advantage in market share, which is what you have to have to survive.

It is very, very successful. It is probably too successful and that is why we are talking about it. It is so successful that in our opinion it has emerged as a barrier to entry.

It does create a condition in this industry that precludes effective competition with respect to other carriers in the industry. So if it is a restraint of trade, which we believe it is, and that is the condition that the combination of American's system and United's system has created, then it has to be dealt with.

If we do not resolve these particular issues in our industry today this way, then we will invite reregulation.

Senator **Danforth**. Could you tell us about slots? How does the ownership of slots benefit an airline? I mean, it seems self-evident to me, but how does it benefit an airline?

Mr. **Beauvais**. I think it is pretty simple. If you have a slot-restricted airport, obviously slots have a value only under those conditions. But if you do have a slot-restricted airport, it preserves a monopoly for those at that airport. You have a slot-restricted condition if the demand for service at that airport exceeds the ability of the carriers to meet that demand.

If the demand is so strong, that creates a price increase condition, and so there is a premium price condition at an airport where you have slot restriction. And for those who have slots, they enjoy that condition.

And for the carriers who want to compete and are precluded from entering the market, then you do not have a market-driven industry at that particular airport and you will continue to have an overpriced product and carriers there enjoying a more than reasonable return on their investment.

Senator **Danforth**. Mr. Crandall talks about the need for capital construction: additional facilities, space, gates, runways, and so on. And I think there is widespread agreement on this committee on that point.

But would you explain how majority-in-interest clauses work and whether the increase in capacity necessarily increases competition?

Mr. **Beauvais**. Well, we support expanding the air transport system and we support building more facilities. But you lost me on the majority-in-interest clauses. I do not follow you.

Senator **Danforth**. Well, it is my understanding that dominant airlines have contractual arrangements with airports whereby they are able to condition the spending of money for improvements on the fact that those additional gates are going to be available to that airline. That fact, in combination with long-term leases, means that dominant airlines have locked up the airport. Once an airline gets in a dominant position, it is unlikely to lose that dominant position, particularly since it has a contractual arrangement with the airport.

Mr. **Beauvais**. Well, we have met that many times as we have attempted to grow in the last 6 years, and in our opinion the lock that airlines have on facilities should be removed.

Let me give you an example. Our hub and spoke is in Phoenix. We are now building a $170 million air terminal facility there.

That is being built by Phoenix on their industrial revenue bonds at their airport, and there is no long-term lease by any airline in that facility and therefore no one has a right to lock up that facility.

In our opinion, that is how airports ought to be managed in the future when you have building opportunities.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. Thank you, Senator Danforth.

Mr. Beauvais, little things jump out at me sometimes in statements. You suggested that the IRS go after all the consumers that are participating in frequent flyer provisions. That is, if we get a little premium then we ought to put it on our income tax and pay for what we receive by being a frequent flyer?

You just scared all the consumers. You frightened them, anyway.

Mr. BEAUVAIS. Right now, if you look at it, the federal government is underwriting the frequent flyer program by offering tax-free advantages for people to take free trips. If a company buys the transportation and the individual who takes the trips is allowed to take a free trip, that person has not paid for it and that is a windfall and that is an advantage.

Senator FORD. You call that a perk?

Mr. BEAUVAIS. Yes, sir. If the individual who bought the trips then takes the trip, that would not be taxable. But as the case has been in the frequent flyer programs, most of the time corporations buy the transportation and yet the individuals are free to take the free trip.

In my opinion, since this is again so widespread and so significant in terms of the competitive development, that it is emerging as a barrier to entry to smaller carriers. And the issue here is to deal effectively with that benefit as it relates to the individual that uses it.

In our opinion, you resolve that by an investigation by the Internal Revenue Service to determine whether or not that should be a taxable benefit. It would not be taxable if the trip were taken by the individual who purchased the required number of trips to earn the trip.

Senator FORD. Well, that bothers me some. You could buy the ticket, give the expense account to your corporate employer, get reimbursed fully and then take advantage of the flight.

What difference does it make if the corporation buys them and then you take advantage of it?

Mr. BEAUVAIS. Well, that is why we urge the IRS to do an investigation, to determine whether or not that is a practical approach. But we do want to focus attention that the frequent flyer program is a major issue in our industry.

Senator FORD. Do you offer frequent flyers?

Mr. BEAUVAIS. Yes. Yes, we do.

Senator FORD. You said that an airline could have a lock on a hub based on the contract or an agreement that you discussed with Senator Danforth. Would you put up the kind of money or guarantee the kind of money that is required without having some advantage?

You know, you would not put up all this money and then say, well, let everybody else use my facilities and I will not take but half the gates I paid for or something. And then how can you take that kind of a deal back to your board of directors and say, hey, I just spent $100 million of your money and we get to use $50 million of it? That is a great deal.

I just do not believe that kind of business transaction would sell well with your stockholders or your board of directors.

Mr. BEAUVAIS. You do not need airline money to build air terminals.

Senator FORD. Oh, I know you go out and sell bonds. But the contract that the airport signs with you as an air carrier underwrites the sale of those bonds.

Mr. BEAUVAIS. You do not have to do it that way.

Senator FORD. Oh, I know you do not have to, but that is basically the way you do it. How many airports have money to do it with?

Mr. BEAUVAIS. Well, that is what I just described in Phoenix. Phoenix is building a major terminal, $170 million.

Senator FORD. Phoenix is doing it themselves?

Mr. BEAUVAIS. Yes.

Senator FORD. Well, then you do not have any money invested in it.

Mr. BEAUVAIS. That is right.

Senator FORD. OK. So if an airline has to underwrite $120 million at Raleigh-Durham and they underwrite those bonds or the bonds are sold based on the contract—that is done everywhere. You find communities of a thousand that will allow a factory to be built: they borrow the money, but the factory underwrites the bonds. Every member of that town owes a million bucks if you want to do that.

That is the way the system works, but somebody had to have some credit in order to make that move. So where Phoenix is building without any cost to an airline, other communities may not be able to do that.

Mr. BEAUVAIS. Well, when that happens and if it is essential for that to happen, there ought to be some ingredients in the commitment that the airline has with respect to using the facility. In other words, there ought to be a certain minimum level of usage on gates that would be obligatory for the airline who steps up and backs such a transaction.

It certainly should not be a situation whereby someone builds a facility and sits on that facility and does not use a major portion of the facility to preclude someone else from coming in to use it.

In addition to that, there ought to be a requirement for an airline to oblige other entrants in that facility at reasonable prices. And so I think that there could be conditions imposed upon the airline willing to do that that still creates a fair competitive environment resulting from the overall transaction, and those are not the cases today.

Senator FORD. Well, in the Raleigh-Durham that Mr. Crandall mentioned, Piedmont was a very active airline, and there has only been a nine-flight reduction since America has been there as a hub. Once maybe you had U.S. Air and Piedmont in there at the time. Now you only have one airline. You just have U.S. Air because they have merged.

So you can say there is a reduction of one airline, but you have basically the same number of flights. It gets a little bit confusing when you do not dig under it just a little bit.

Now, did America West come into the competition knowing full well that American and United and others had CRS?

Mr. **Beauvais**. Yes.

Senator **Ford**. You are complaining about it a little bit now.

Mr. **Beauvais**. Well, the issue is in our opinion an issue that is far more profound today than it has been in the past. I think that is why you do not see new entrants in the airline industry any more.

Senator **Ford**. You mean CRS is preventing new entrants?

Mr. **Beauvais**. It is a major barrier to entry.

Senator **Ford**. Well, what about when they tried to set it aside and let Delta and others buy a percentage of it. It would take a while, I guess, to make it an independent entity and for you to be a part of it and buy a portion of it. And DOT said no.

I never could understand that one. We have been hearing complaints that America has the CRS and others cannot use it. All of a sudden America sets it at the side and says, "there it is, fellows, buy a piece of it."

And then DOT says, no, you cannot do that. We want American and United and the rest of them to continue to have their CRS.

Mr. **Beauvais**. We were offered an opportunity to buy a piece of SABRE, but I would like to equate it to Mr. Crandall's example of the $15,000 car transaction. The price to us for that $15,000 car was $100,000, and so we did not think it was a very fair transaction.

When we went to the investment community to finance it, they said that the return does not even come close to justify that kind of financing. When we evaluated the terms and conditions offered to us, it gave us no voice in the management of the CRS system, even though we were an owner and a major investor.

It did not make any sense.

Senator **McCain**. And Mr. Chairman, if I might interrupt, I believe the Department of Transportation's rationale for turning down this proposal was not because they were opposed to the CRS unloading per se. It was because the Department of Transportation believed that the deal was patently unfair to investors such as other airlines.

Senator **Ford**. Well, if it is out there and it is separate and a deal is made, you either sign it or you do not sign it, and that is the way business is done. I have always operated under those circumstances.

Let me ask you then, Mr. Beauvais, what alternatives to divestiture of the computer reservation systems can you suggest?

Mr. **Beauvais**. Well, as far as we can see divestiture is the only practical alternative. It adequately compensates American for their investment. It more than compensates them for their investment. It is a very valuable independently owned technology company.

The only other thing that could be done is to have an industry-owned system, is to have American agree to sell it to the industry—they could be compensated for it—and to have the carriers who own it with an equal voice in managing the system. And nobody has proposed that.

Senator **Ford**. Well, every phase of business that is in some agency, whether it be insurance or airlines or whatever it might be, the entity for which, you are the agent, puts a machine in your place of business. Now, I do not see anything so strange about that because that is in the competitive world everywhere, whether it may be a Wang machine up to a CRS.

It is out there and it is available and it is part of the competition today. So when you come in here banging the CRS, that has been out there for a long time, because you do not have one or it is too expensive for you to get into, I just think it may be good business.

And you are saying that an outfit that ten years ago developed CRS, offered it to other entities who did not take it. Now it is one of the major impediments to competition according to you. Somehow or another, I just think that is a little bit crying over spilt milk.

Mr. **Beauvais**. Well, obviously, obviously you have to take—I say you have to take what Mr. Crandall says and you have to balance it. But if we are right, if America West is right in this position and it is a barrier to entry and it is a major restraint of trade in our industry and it is going to get stronger, not weaker, then we are going to invite reregulation on our industry, because if we have these conditions then it will preclude effective competition in our industry.

I think issues like this have to be weighed on, is it good for the competitive balance in the industry? If it is, then we have to investigate issues like this.

Now, I am not going to. I am an airline. I am going to survive somehow. American's going to succeed somehow. But the issue I think is are we building an airline industry that has an effective and healthy competitive balance to it? Because it will take care of itself if it does, and Congress does not have to reregulate.

Senator **Ford**. You say the Congress should get involved and make all these changes, and those changes will make a level playing field. You say if somebody has an advantage, you take that away from them, then we are going to have competition. Somehow or another, that just gets to this free trader that it is not right, that you come up here to Big Brother and say to Big Brother: You take his competitive advantage away from him so that I might be able to compete more with him.

Something about that does not set well in my stomach.

Mr. **Beauvais**. If it creates a monopoly, I think we have learned over the years that that is not good.

Senator **Ford**. We have got monopolies statutes on the books.

Mr. **Beauvais**. That is right.

Senator **Ford**. If they get too far, then you can rein them in.

Mr. **Beauvais**. That is right.

Senator **Ford**. But you do not have that yet, do you?

Mr. **Beauvais**. I think we are heading in that direction.

Senator **Ford**. Sure, you have General Motors, too, and you are headed to that direction. But we still have the ability to rein them in.

So there is something about—I am going to quit, but there is just something about saying to another fellow he has a competitive advantage and, boy, I do not like it and I want Big Brother to take care of it.

Big Brother is taking care of so damn many things, we almost did not pay our bills today. So now if you are looking at us to take care of your business, you better go back and look at your own damn books and leave us alone.

Senator McCain.

Senator McCain. Thank you, Mr. Chairman.

I would just like to point out that, with regard to CRSs, it is not a difference of opinion, per se, between a smaller airline and a larger airline. It is an opinion shared by several GAO studies, by a Department of Transportation study, and others which we rely on for objective opinions as to what is the true situation.

All of those studies indicate that the present employment of the CRS is a severe impediment to a free and open competition, thereby causing, in the long run, the airline passenger to not receive the benefits of a truly deregulated industry.

The so-called halo effect translates itself into a variety of ways, which frankly I do not think even perhaps the initial purchasers of CRS' had contemplated. But they grew over time. I do not think that even the initial purchasers of CRSs know the kinds of benefits the "halo effect" would provide for them.

And I would suggest that the CRS proposal made by American and Delta was simply not fair to competition, and the reason that Department of Transportation turned down that proposal is because it was basically anti-competitive.

I can also appreciate that these two airlines developed CRSs on their own. But the GAO has stated that the reason why they were able to develop CRSs was because of the air routes that they received from the CAB during regulation.

Just briefly, Mr. Beauvais, I know you have been here a long time, and I appreciate it. Would you just describe the "halo effect, 'exactly what that means.

Mr. Beauvais. Well, if you go wingtip to wingtip there is probably a 30 percent market share advantage for the CRS carrier-owner-provider, and that is probably a conservative estimate. That is the halo effect, 30 percent.

If we have the same capacity and go wingtip to wingtip and one carrier has 50 percent of the market and the other one has 30 percent less than that or 35 percent with the same costs, the the one with 50 percent has a greater advantage. That 50 percent is produced by the fact that all the reporting inside the travel agent is provided by the CRS system, thc better access to the reservation record of the CRS supplier is provided.

The override commission plays a major role in that. There is a minimum booking requirement on SABRE per unit provided that travel agent that is required or that travel agent must pay for the equipment. Other than that, they will get it free.

Plus the reports that flow from that flow daily to the CRS carrier-owner-provider. They transmit that to their sales department. They are all over the travel agent within days based upon changes that they see, that we have no knowledge of.

So there is just a superior information flow that allows them to manage their interrelationship with that travel agent much more effectively.

And then, in spite of all of the efforts on display,, there is still a display advantage for the CRS carrier-owner. And there is timing on entry for transactions, such as schedule changes, that the CRS carrier-owner enjoys.

Senator McCAIN. Thank you.

Thank you, Mr. Chairman.

Senator FORD. Jack, do you have anything?

Senator DANFORTH. No, I do not.

Senator FORD. Mr. Beauvais, I hope you can convince me, a small businessman that has been fighting with the big boys all my life. The big ones always have been putting me out of business. I do not know any other way to do it. I have never been able to come up here to Congress to set me up in business, to be sure that I make a profit.

So I am not too sympathetic with eliminating competition between entities that got into a field knowing full well it was all there.

I am sure Senator McCain will have an opportunity to convince me. And Jack Danforth is too big to argue with, but I run fast. So we look forward to working this out.

I enjoy what I do and I hope you are not offended.

Senator McCAIN. Mr. Chairman,, I have noted that you always have an open and fair approach to these issues.

Senator FORD. Open anyhow.

Thank you, Mr. Beauvais.

Next is Mr. James W. Callison, senior vice president for legal and Corporate affairs for Delta Airlines.

STATEMENT OF JAMES W. CALLISON, SENIOR VICE PRESIDENT, LEGAL AND CORPORATE AFFAIRS, AND SECRETARY, DELTA AIR LINES, INC.

Mr. CALLISON. Thank you, Mr. Chairman. On behalf of Delta, I really appreciate this opportunity to present our views on the issue of competition in the airline industry and our views on S. 1741, the proposed Airline Competition Enhancement Act.

My written statement, Mr. Chairman, is in two parts. The first part, upon which I will not dwell orally here this morning, addresses the conclusions that some seem to have reached that the airline industry may have become too concentrated and that competition therefore may somehow have been diminished.

I show in that part of my written statement that just the opposite is true, that under deregulation free market forces have resulted in an intensification of competition and an increase in service and fare options that have been increased nationwide; that free market forces have shaped a multiple hub and spoke system which:

One, has resulted in competition not only between airlines, but between hubs, thereby intensifying airline competition; two, has strengthened the commuter industry, which now competes within itself and with major carriers; and three, has also enhanced airline efficiency and productivity, thereby helping to hold down costs and hence fares.

As a result of the hub and spoke system, smaller communities have improved access to a vastly more comprehensive national air transportation system.

The pricing scheme that has evolved, while criticized by some, is in fact rationally related to the costs and to the underlying marketplace factors of the various city pairs served and the various types of service available and, on average, after adjustment for inflation, has produced lower fares than before deregulation, having saved, as we said earlier in this hearing this morning, the public billions of dollars in savings.

Now, the many service and price options that exist today are essentially the product of the dynamics of the marketplace. Anyone interested in competition in this industry, the airline industry, must ask the fundamental question whether regulation or reregulation of airline economic practices would create a better result for consumers than free market forces?

And that brings me to the second part of my written statement, which deals with S. 1741 specifically, and it is that part I want to concentrate on in my available time orally here this morning.

We frankly think that bill, if passed, would threaten the consumer benefits which have been made possible by deregulation. Most of the so-called barriers to competition that are addressed in that bill are not in fact impediments to competition.

The proposed remedies would unnecessarily disrupt relationships among airlines, their customers, travel agents, and airports, and create new costs that would adversely affect the quality and quantity of the many price and service options which deregulation has made available to consumers.

S. 1741 in Delta Air Line's view would quite simply be a major retreat from deregulation. Let me just spend a few moments reviewing each of the proposed sections of that bill specifically and just in summary form.

First let me talk about computer reservation systems. We have heard a lot about that this morning. Delta Air Lines does believe that there is a need to inject more competition into the CRS industry, that there is a need to eliminate the unfair use of those systems for airline competitive purposes, and that there is a need to foster their evolution into neutral, no-host information distribution systems.

However, divestiture in our opinion is not the answer. The CRS industry has simply not developed to the point where non-airline owners could, solely through booking fees, generate sufficient revenues to enhance the products and the services offered by CRS vendors to their clients.

If CRS systems were to be divested from the airline industry today, we project that booking fees would increase significantly, producing a rise in air fares to our customers.

We believe a far better solution to the competitive problems that exist within the CRS industry is the issuance of, first, new rules by the Department of Transportation to eliminate such specific practices as rollover clauses, 5-year contracts, minimum use requirements, and segment-fee-based liquidated damages. These are problems.

Secondly, we think another new rule should be issued requiring that all CRS systems provide the same real time availability of flight information to all airlines, not just to the host carrier, thereby eliminating the last vestige of bias that does still exist in the CRS business.

But the Department of Transportation already has ample authority to regulate in these areas, and DOT already has a rulemaking pending with respect to revision of and extension of the existing CRS regulations. We do not think divestiture or any other legislation is needed in that area.

Let me turn to code-sharing. We have also heard about that this morning a good bit. Delta strongly opposes—let me repeat, strongly opposes—any attempt to eliminate code-sharing. We believe these arrangements have been extremely beneficial to the traveling public, that they have helped improve service, frequency and reliability by creating the equivalent of on-line services to numerous small and medium communities, services that otherwise would not exist.

They have also reduced air fares.

Ironically, S. 1741 would eliminate code-sharing between commuters, as we read it, and their larger air carrier partners only when the commuter is not owned or controlled by the larger airline.

Delta's connection carriers operate as independent companies, not owned by Delta. We have an investment in some of them, but they are not owned by Delta. S. 1741 would place these independent commuters, and thereby of course Delta, at a terrible competitive disadvantage vis a vis wholly owned or controlled commuters.

Such a result could hardly enhance competition. Indeed, it would reduce the extensive competition that the present system has stimulated and developed.

I should point out here that the Department of Transportation has used, has already used, its section 411 power to ensure that consumers are not misled or deceived by code-sharing. I think that is sometimes a concern. DOT has regulations and we have principles by which we operate ourselves to prevent deception or misleading of customers.

The DOT has promulgated a policy statement which requires carriers to give reasonable and timely notice to consumers of the existence of code-sharing arrangements, and DOT enforcement staff have closely monitored the carriers to ensure compliance, and I can assure you that we at Delta Air Lines go out of our way to be sure we comply with those regulations.

Now let me turn briefly to regulation by the Federal Trade Commission. I guess I am going to echo a little bit what you have heard earlier. The proposal to eliminate the exemption contained in section 5[a][2] of the Federal Trade Commission Act would unfairly in our opinion single out the airline industry for duplicative regulation in the same area of activity by two different offices of the federal government.

In our opinion, there is absolutely no justification for that. The proposal implies that competitive practices in the airline industry are not being effectively regulated by the Department of Transportation. To the contrary, we believe the Department has done a very effective job in regulating a whole variety of airline consumer and competitive concerns and that there already exists adequate authority in the Federal Aviation Act and regulations developed by the Department to redress any consumer problems.

If you sponsors of the bill believe, Senator McCain and Senator Danforth, that the Department of Transportation has not done an effective job in administering its responsibilities, then I would suggest that you identify those areas where additional DOT attention is needed, rather than exposing the airlines to needless, duplicative, and therefore wasteful federal regulation.

Now, section 411 in another aspect. You have also proposed to enhance DOT's powers under 411. That again says that somehow that section has not been effectively utilized by the Department of Transportation, and I do not think the facts support that assumption, either.

Based upon our research, we have found that since the Department received this authority—of course, it is old authority from 1938, but since they received it in the deregulation movement—in 1985, 103 different orders and decisions containing references to section 411 have been issued by the Department.

Of this total, 62 orders and decisions contained substantive discussions of section 411 and its powers and how the DOT would use those powers.

More importantly, the proposal broadening DOT's section 411 powers in the bill that you folks have put in frankly would establish, in my viewpoint at least, in Delta's viewpoint, a judicial and regulatory formula that would be unfair, arbitrary, and capricious. We just do not see any justification, frankly, for going that far.

We think 411 in its present form gives the Department all kinds of flexibility. As the discussion earlier today indicates, I think your suggestions with respect to 411 in part are intended to deal with majority-in-interest clauses and long-term leases, so let me address those for just a few moments.

I think you think they inhibit competition at the hubs, and I hope I can show you very briefly they do not do that. We do not think the facts support those conclusions.

Turning first to majority-in-interest clauses, as you know, they are used in airline-airport contracts to prevent the inclusion in airline rate bases of the costs of constructing excessive or unnecessary capital projects. That is what their purpose is.

What they really do is protect the airlines from what really is a monopolistic position that the airport operator has. Without those majority-in-interest clauses, the cities and the airports could dictate what is done at airports. They could impose unnecessary costs which would have to flow through to consumers.

So what the majority-in-interest clause really does is make the airline and the city and the airport that the city operates partners so they can work out what the projects should be, what their scope should be, what their size should be in a sensible way. And that just simply gives the airlines a voice, as the Department of Justice has noted, gives the airlines a voice in how their money will be spent.

And that to us makes perfectly good sense where you have major facilities to be developed.

We have surveyed all domestic airports that Delta currently serves and we could not find any airport within the last two or three years that has not been able to undertake a major project as a result of majority-in-interest clauses.

The facts simply do not support the suggestion that such clauses prevent the construction of airport expansion needed to permit additional competition or that they are otherwise anti-competitive.

A few words about long-term leases. Long-term leases are not always needed. That conversation took place a few moments ago with Mr. Beauvais. Airports can build facilities other ways.

But where cities and airport authorities need to rely on airline revenues and airline support, long-term leases really make an awful lot of good sense, and they do not deny access by other carriers or new entrants to those airports.

Since deregulation, Delta has inaugurated service to 31 new domestic cities. We have not experienced any significant problems in obtaining gates, ticket counter space, or other important facilities at any of those airports.

Now, we did not always get our first choice. We did not get the counter space at the front, by the front door to the airport. But we were able to go into each of those 31 airports, which looked to be full when we first glanced at them.

We are also not aware of any other carrier that desired new entry space at the Atlanta Airport or any other cities where we are privileged to serve that could not obtain such space. Again maybe not its first preference at the outset, but they could get in and operate if they wanted to.

It therefore appears to us that this really is another issue where the problem is more theoretical than it is real.

Let me turn briefly, so I do not take too much time, to passenger facility charges. We at Delta recognize that the 8-percent ticket tax may not adequately provide resources needed for the many airport capital projects that will in fact be needed in the future.

While we are willing to consider augmenting the user fee revenues to finance airport developments outside of the Federal program, and we think many airport developments will be needed, we believe that the question of airport funding should be addressed only as an integral part of overall decisions made during reauthorization of the program regarding the use of the aviation trust fund.

Additionally, if passenger facility charges are authorized, we think that any mechanism of that type must maintain eligibility and airport retention and airline consultation requirements set forth today under Federal laws and regulations. And we must insist that the airlines continue to play a major role in how these moneys will be spent in the future.

Unfortunately, S. 1741 does not really address these issues and establishes a process which we think would probably force airlines and airports into adversarial positions before the Department of Transportation to decide what should be done under the revised Section 411, and we think that would be very, very unfortunate.

Slot allocations, that may be the last subject, slot allocations. As you recall, Mr. Chairman and Senators McCain and Danforth, Delta opposed the buy-sell provisions prior to their adoption in 1986. We felt strongly that the Government's efforts should be focused instead on the need to expand capacity and to eliminate artificial constraints, including slot removal; and we continue to urge that this be the primary focus of the Government's attention.

At the time the buy-sell program was created, however, we felt that acceptance of that regime would in fact hinder progress in the development of new capacity, just as the basic high-density rule itself has done for some decades now.

I should also note that since its inception Delta has not bought or sold slots at any of the four high-density airports. Now, we have traded some slots at several of those airports, but we have not used that process for financial gain.

We do not believe that Delta owns the slots and we do not reflect a book asset value for them on our balance sheets.

While we have not bought or sold, though, now that we have had some experience with the buy-sell program we cannot think of a better system. We think that the buy-sell system has indeed turned out to be an efficient allocator of scarce resources at those airports.

The system has allowed airlines to develop services to hubs and non-hubs consistent with market demand. We believe it would be unwise to replace those market forces with government regulation and that is really what the proposal is.

It would be unwise to replace market forces with government regulation and engage in a process of substitution, which is what the proposal would do, whereby the Federal Government would decide which communities deserve service to any one of those four airports. That in my opinion would be stronger economic regulation than we had prior to 1978.

It would be far better, we think, to leave the status quo in this area, and that is what we urge. If you are going to change the status quo, then we think maybe, instead of such draconian action as that proposed in S. 1741, that maybe a couple of other things could be done.

For example, the high-density rule itself might be re-examined. Maybe you ought to put into it a self-destruct date, because it does not seem to go away if you do not do that, if somebody does not do that, so that attention will have to be focused on where it should be focused, on expanding capacity.

Or maybe you could do what Mr. Crandall said, require them to add a slot or two every hour once in a while. Something like that would be better, we think, than the proposal in S. 1741.

Secondly, if you are going to review these rules and especially if you are going to conclude that perpetual retention of slot controls is necessary, then probably the government should look at how all the slots available—commercial, general aviation—all of them available at those airports are being used and make decisions that would maximize the public interest.

Those are our brief comments, Mr. Chairman. They are expanded upon in our written statement. I want to thank you again for the opportunity to appear here today to provide some of Delta's views on these subjects and on the competitive state of the airline industry, and of course I will be glad to answer questions if you have any.

[The statement and questions and answers follow:]

STATEMENT
OF
JAMES W. CALLISON
SENIOR VICE PRESIDENT-LEGAL AND CORPORATE AFFAIRS
& SECRETARY
DELTA AIR LINES, INC.

Mr. Chairman and Members of the Subcommittee, my name is James W. Callison. I am Senior Vice President-Legal and Corporate Affairs & Secretary of Delta Air Lines. On behalf of Delta, I appreciate this opportunity to present our views on the issue of competition in the airline industry and S. 1741, the proposed Airline Competition Enhancement Act.

INTRODUCTORY REMARKS CONCERNING THE HIGH LEVEL OF SERVICE AND PRICE COMPETITION IN THE AIRLINE INDUSTRY.

Before addressing the specific provisions contained in S. 1741, I would like to rebut the contentions of some that there is undue concentration in the industry which has resulted in a significant diminishment of competition, and that the hub-and-spoke system of scheduling has stifled entry and increased fares.

While I do not believe it is necessary for me to detail for Members of the Subcommittee the profound changes which have occurred in the airline industry since passage of the Airline Deregulation Act in 1978, I think it is extremely important for purposes of examining competition today that we look at the entire experience during this nearly eleven year period. As you continue your review, I hope you will keep in mind that the shape and structure of the industry today, and during each year of the deregulation experience, reflect the forces of the free market system at work. While there certainly have been many governmental and other artificial constraints that have impeded the free market, the service and price options that exist today are still essentially a product of the dynamics of the marketplace. Anyone interested in competition in the industry must ask the fundamental question, whether regulation of economic practices would create a better result for consumers than free market forces.

The development of the hub-and-spoke systems that now blanket the entire nation has intensified airline competition and allowed carriers to offer a far broader array of price and service options to both passengers and shippers than would have otherwise been possible. The systems have increased efficiency, held costs in check, and saved the public billions of dollars. The Brookings Institute estimates that deregulation has meant an annual savings of $10 billion measured in 1988 dollars. The hub and spoke operations have spawned the commuter industry, which has further increased industry competition.

As Members of this Committee know well, the industry has undergone many revolutionary changes since deregulation and as a consequence, it is vastly different and more productive and efficient than it was in 1978. This is primarily because of the expanded and integrated hub-and-spoke systems that deregulation permitted. Indeed, under the freedoms of deregulation, the hub and spoke concept which Delta pioneered in Atlanta in the 1950s has been copied and perfected to such an extent today that one rarely hears the old saying, "When you die, whether you go to heaven or hell, you have to change planes in Atlanta."

The reason for this is that the number of hubs in the South Atlantic region has increased from one to eight since 1978, just as nationwide, the number has increased from four to 35. As we at Delta are well aware, travelers to and from the South Atlantic region have price and service options available today at hubs located in Memphis, Nashville, Raleigh/Durham, Charlotte, Orlando, and Miami as well as Atlanta. I can assure you that competition for passengers to spoke cities like Columbia, Charleston, Savannah, Knoxville and many others is fierce, regardless of the market share of a single carrier at any of those hubs. This illustrates that, as the hub systems have grown competition has developed among the hubs, intensifying competition between the hubbing airlines, between the hub feeding commuter carriers and, in many instances, between the commuters and the major carriers. So, today, competition is both hub-to-hub and carrier-to-carrier.

For example, a traveler going from Savannah, Georgia to Los Angeles has a daily choice today of sixteen different connecting services on four different airlines at three different hubs. To New York City, there are two nonstop single-plane services plus twenty-two connecting flights available each day with a choice of four airlines through five different hubs. As a result of hub-and-spoke systems, smaller communities have better access to the air transportation system. Nonstop flights to hubs from cities formerly served only by local service carriers has increased 78% in the past ten years. (In addition to this intensified hub-to-hub competition, at the thirty large non-hub airports nonstop flights to points other than hubs increased 18% over the past ten years.)

The competition among hubs I have been discussing is for traffic moving to and from the so-called spoke cities, whose single-carrier service and fare opportunities have been greatly enhanced by that competition. But what about traffic moving to and from the hubs themselves, rather than through them? An accurate judgment about competition at the hub itself requires a separate examination of just the local traffic. At most of the major hubs in the United States, the dominant air carrier has a signficantly lower share of the local traffic than it does of the total hub market. The larger share of the total market reflects the connecting traffic carried as well as local traffic at the airport. However, the share of the local market reflects the fact that what is a hub for one carrier is a spoke or a major service point for many other carriers that serve the city, which in turn produces good competition for the hub city.

Delta's Salt Lake City market is a very good example of a concentrated hub that has significant competition for local traffic. Delta carries more than 80% of the total enplanements at Salt Lake City because of our extensive connecting pattern at that point. However, our share of the local market in Salt Lake City is less than 55%. In Cincinnati, Delta enjoys a 78% total market share but carries only 63% of the local market.

So while so-called dominance of a hub provides an extensive pattern of single carrier service for a large number of spoke cities, it does not mean the absence of competition in origin and destination traffic at the hub itself.

Moreover, there are no insurmountable barriers to new entry at existing hubs. Indeed, each of Delta's major hubs -- Atlanta, Cincinnati, Dallas/Fort Worth, Orlando and Salt Lake City -- has experienced an increase in the number of scheduled jet airlines serving them since 1978. Moreover, the catch phrase "fortress hubs" seems to imply that another carrier cannot set up a hub of its own in competition with an incumbent hub operator. But that is not true. Delta, for example, has established a hub at Dallas/Fort Worth in competition with the original hub operator at that city, American, and Delta's market share has steadily increased as the size of Delta's own Dallas/Fort Worth hub-and-spoke system has grown in number of flights and georgraphic coverage. We intend to continue increasing the size of Delta's hub system at Dallas/Fort Worth.

In short, the hub-and-spoke system has fostered increased, improved and more efficient service and helped intensify airline competition.

Let me now turn to airline fares.

This Committee is certainly familiar with the recent study conducted by the General Accounting Office which suggested that fares at the top fifteen concentrated hubs were 27% higher than comparable non-hub cities. What the GAO study does not analyze are the costs or the prevailing economic or individual marketplace factors that relate to the prices cited in the GAO study.

One marketplace factor is quality of service. Hubs tend to have more nonstop jet service than non-hub cities. Nonstop jet service is the highest quality air service available, and generally is priced higher than intermediate-stop or connecting service. This means that because of their higher proportion of nonstop service, hubs will, on the average, have somewhat higher fares than non-hubs. This is especially so when a hub is being developed. During that stage, it is characterized by a relatively high proportion of short haul spokes. Short haul operations are more costly so short haul fares tend to be higher on the average. But statistics show that as a hub matures, its average fare levels will move more closely to the industry average, although, again, because of the higher proportion of nonstop service, the hub's fare level may remain somewhat above the average.

All the studies with which we are familiar suggest that consumers expect to pay more for higher quality, whether one is dealing with goods or services. As a result, it is to be expected that as a new hub like Cincinnati is being developed and its service quality is rapidly rising, its fares will also tend to increase faster than will fares at more mature hubs like Atlanta.

Some critics have suggested that while average system fares are down, the airlines are charging excessive fares to those who travel between hub cities. This simply is not true. Our pricing is based first on a fixed cost associated with getting an aircraft into the air and, second, on per mile cost in flight. Since per mile cost tapers downward with distance flown, shorter flights will cost more per mile. This same basic formula is used between hubs, as well as elsewhere.

Another erroneous allegation is that once a hub becomes concentrated, average fares increase because there is no competitive incentive to offer the greater portion of inventory at deeply discounted fares. That has not been our experience at Delta. In June of this year, there was an increase of 32.9% in the number of passengers traveling on our most deeply discounted fares over the same month in 1988. Further, we offered more than six million seats or 61.3% of our total June capacity at deeply discounted non-refundable fares, an increase of 40.9% from the number of seats available at those fares as recently as 1988. Comparable percentages existed in July, August, September and October of 1989. Those numbers were system averages, but similar offerings were made at Delta hubs themselves. During August, Delta offered over 58.2% of its seats in Atlanta at deeply discounted, non-refundable fares, 67.8% at Cincinnati, 69.0% at Salt Lake City and 70.1% at Dallas/Fort Worth.

The numbers cited for the month of June occurred during a time period when one of our major competitors in Atlanta and in the eastern part of the United States had temporarily curtailed most service. Delta nevertheless offered the high level of discounts I just described. I might also note that this same competitor has now rebuilt its service and it is carrying more passengers today in Atlanta than it did before its operations were halted as a result of the work stoppage.

The $10 billion annual savings together with the high volume of discount seats available underscores the great number of fare options which deregulation and the hub-and-spoke sytem has provided the public.

Mr. Chairman, let me now turn to the industry's profit situation. As some in our industry have suggested recently, if the airline industry is engaged in monopolistic pricing, then we must be the dumbest monopolist in America. If you look at the profit margins of Delta or our industry in general, you certainly cannot come to the conclusion that we are making excessive profits. This goes back to my point about the GAO's looking at prices in isolation without regard to costs.

In the twelve month period ending June, the airline industry has enjoyed significantly improved financial returns. Nevertheless, all the scheduled carriers (excluding Eastern) had a profit margin of only 3.7% and the five most profitable -- American, Delta, Northwest, United and USAir -- enjoyed only a 5.6% profit margin. Even more significant, during the first five years of deregulation the industry had an operating margin of a negative 0.5%; and only a 4.1% operating margin during the second five years of deregulation. The fact that the industry did not earn higher profits underscores the fact that our intensively competitive industry has returned enormous benefits in the form of lower air fares to the American consumer.

But while the industry strives to keep fares low, the airlines must cover costs and earn a reasonable profit. We should be earning more than we are. The industry faces an enormous investment for new aircraft. Delta's investment alone will exceed $13 billion over the next ten year period. Despite the higher profit levels experienced during the most recent twelve months, and even though Delta's debt/equity ratio is the lowest in the industry, our internally generated cash flows will not be sufficient to cover our future capital expenditures. We will be forced to pay for a large portion of the acquisition expense of these quieter, safer, more technologically advanced and efficient airplanes through externally generated funds, and those borrowings and their costs must be covered.

Any review of the hub-and-spoke system and its benefits must include an assessment of the economic impact associated with their development. I can assure you that consumers in cities like Cincinnati, Raleigh/Durham, Nashville and Salt Lake City have not only enjoyed a greater variety of price and service options as a result of hubs that have been developed at these airports, but they have also seen an enormous economic investment that greatly benefits their communities. As a result of Delta's decision to build a hub in Cincinnati, Delta is now contributing in excess of $311 million on an annual basis to the greater Cincinnati area. The contribution in Salt

Lake City is approaching one-half billion dollars a year. I might add that this economic infusion is strictly Delta's contribution and does not take into account all the ancillary services, jobs and infrastructure that result from our decision to establish hubs in these cities. The benefits do not flow just to the hubs themselves -- the hubs support improved and often increased service at spoke cities, and the systems therefore benefit wide regions and many cities. The hub-and-spoke systems also support commuter new entrant carriers, which provide additional employment and contribute millions more to local economies.

S. 1741 -- AIRLINE COMPETITION ENHANCEMENT ACT

Mr. Chairman, we at Delta -- like the sponsors of the proposed Airline Competition Enhancement Act -- are concerned that "de facto re-regulation" may be occurring. But we see the causes and cures quite differently than they do. In our view, the benefits of deregulation are being eroded because of airspace and airport capacity shortfalls, not because of carrier reactions to the free market forces unleashed by deregulation.

We strongly disagree with the proposition that competition can be enhanced by placing enormous power in the hands of the Federal Government to regulate industry economic practices. Existing safeguards are completely adequate to protect competition and the consumer, and the agencies of government have demonstrated that they can and will use their powers to enhance the competitive marketplace and prevent abuses.

We believe that most of the so-called barriers to competition addressed in this legislation are not, in fact, impediments to competition and that the proposed remedies are both unwise and contrary to the preservation of a deregulated environment. Make no mistake, these proposals would unnecessarily disrupt relationships among airlines, their customers, travel agents and airports and create new costs that ultimately will adversely affect the quality and quantity of price and service options available to consumers. S. 1741 would be, quite simply, a major retreat from deregulation.

Let me a spend a few moments reviewing each of the proposed remedies contained in S. 1741.

DIVESTITURE OF COMPUTERIZED RESERVATIONS SYSTEMS

Delta Air Lines shares the concern expressed by many that control of large CRSs by a major air carrier does aid such a carrier in attaining and perpetuating dominent positions in the airline market, and does lead to CRS practices that prejudice other carriers. There is a need for governmental action to "level the playing field," to inject more competition in the CRS industry and to eliminate the unfair use of these systems as an airline competitive tool. Delta continues to strongly favor federal regulatory proposals that foster the evolution of the CRS industry into neutral, no-host information distribution systems that serve the needs of the travel agents and their customers. However, divestiture is not the answer.

A forced divestiture of airline ownership at this point would be highly disruptive to the important benefits derived from these information distribution systems. The CRS industry has simply not developed to the point where non-airline owners could, solely through booking fees, generate sufficient revenues to enhance the products and services offered by CRS vendors to their clients. If CRS systems were to be divested from the airline industry today, we project that booking fees would increase significantly, producing a rise in air fares to our customers.

One especially troubling aspect of the divestiture proposal contained in this legislation is that foreign airlines could acquire these systems and use them as a competitive weapon against U.S. carriers at a time when global competition is increasing.

We believe a far better solution to the competitive problems that exist within the CRS industry is the issuance of new rules by the Department of Transportation to eliminate such practices as rollover clauses, five year contracts, minimum use requirements and segment-fee-based liquidated damages. The Department already has ample authority to regulate in these areas, and we are optimistic that Secretary Skinner will propose such changes when the Department of Transportation finalizes pending rulemaking extending and modifying the existing CRS regulations.

In addition to making the CRS industry more competitive, we also believe that DOT should eliminate the last remaining vestige of bias that exists in the CRS area, namely, the incentive for travel agents to book a disproportionate number of flights on the host airline. The DOT CRS rule should be amended to require that all CRS systems provide the same real time availability of flight information for all airlines, not just the host carrier.

CODE SHARING

Delta strongly opposes any attempt to eliminate code sharing. We believe these arrangements have been extremely beneficial to the traveling public, that they have helped improve service, frequency and reliability by creating the equivalent of on-line services to numerous medium and small communities that otherwise would not exist. They have also reduced air fares since improved efficiency lowers a carrier's cost and these savings can be passed on to the passengers.

Ironically, S. 1741 would eliminate code sharing between commuters and their larger air carrier partners only when the commuter is not owned and controlled by the larger airline. Delta's connection carriers operate as independent companies, not owned by Delta, and are major examples of small business at its best. S. 1741 would place these independent commuters at a terrible competitive disadvantage *vis a vis* wholly-owned or controlled commuters. Such a result can hardly enhance competition.

Because Delta does not own its commuter partners, Delta and its partners would be at an enormous competitive disadvantage if major carriers that have purchased their commuter partners were allowed to continue to display connecting services as on-line services by virtue of their ownership and control. As proposed in the bill, Delta's four commuter partners would be penalized for being independent.

At Delta's four hubs, our commuter partners do compete extensively with both commuters of other airlines and with pre-deregulation carriers. For example, COMAIR competes at Huntington with USAir for traffic that can move either on COMAIR to Cincinnati for direct connections to Delta, or on USAir to Charlotte for connections there. Without code sharing COMAIR would not conduct this competition, and the pre-deregulation carrier's Charlotte hub would thereby be shielded from competition. This same pattern is repeated throughout the COMAIR Cincinnati and Orlando systems; it demonstrates strong commuter-major carrier competition that exists in addition to the extensive commuter-to-commuter competition to move traffic over different hubs and/or different long haul carriers; and it shows how code sharing and the hub-and-spoke systems intensify industry competition.

I should point out here that the Department of Transportation has used its Section 411 power to ensure that consumers are not misled or deceived by code sharing. The DOT has promulgated a policy statement which requires carriers to give reasonable and timely notice to consumers of the existence of code sharing arrangements, and DOT enforcement staff have closely monitored the carriers to ensure compliance.

Thus, consumers have reaped enormous benefits from code sharing arrangements, and there has been no evidence of anticompetitive behavior or any significant adverse consequences. To the contrary, code sharing with the commuter carriers has enhanced competition in the industry.

REGULATION BY THE FEDERAL TRADE COMMISSION

The proposal to eliminate the exemption contained in the Section 5(a)(2) of the Federal Trade Commission Act unfairly singles out the airline industry (which Congress decreed in 1978 was to be treated the same as other businesses) for duplicative regulation in the same areas of activity by two different agencies of the Federal Government. There is no justification for this!

The proposal implies that competitive practices of the airline industry are not being effectively regulated by the Department of Transportation. To the contrary, we believe that the Department of Transportation has done an effective job in regulating a variety of airline consumer and competitive concerns, and that there already exists adequate authority in the Federal Aviation Act and regulations developed by the Department of Transportation to redress any consumer problems.

It is patently unfair for Congress to require that airline competition and consumer practices be regulated by two separate entities of the Federal Government. We believe that this would create unnecessary, duplicative and confusing rules that would be detrimental to airline consumers. It would also be a waste of governmental resources at a time when primary emphasis should be on conservation and expense reduction. If the bill sponsors believe that the Department of Transportation has not done an effective job in administering its responsibilities, they need to identify those areas where additional DOT attention is needed rather than exposing the airlines to needless, duplicative federal regulations.

ENHANCING POWERS OF DOT UNDER SECTION 411 OF THE FEDERAL AVIATION ACT

The authors of S.1741 suggest that Section 411 of the Federal Aviation Act has not been effectively utilized by the Secretary of Transportation. The facts simply do not support this assertion. Based upon our research, we have found that since the Department received this authority on January 1, 1985, 103 orders and decisions containing references to Section 411 have been issued. Of this total, 62 orders and decisions contained substantive discussions of Section 411.

More importantly, the proposal broadening DOT's Section 411 powers in this proposed legislation establishes a judicial and regulatory formula that is unfair, arbitrary and capricious. It is ludicrous to suggest that Delta's successful market share in Atlanta, Cincinnati, Dallas/Ft. Worth and Salt Lake City could create a presumption that we are engaging in unfair and deceptive practices or unfair methods of competition at these airports. Delta has been privileged to serve more than 40% of the enplanements at Atlanta since before deregulation, thereby providing one carrier service to the entire Southeast area, aiding its post-World War II development; on what basis is it suddenly to be presumed that this beneficial public service constitutes an unfair or deceptive practice or method?!

The bill sponsors would grant these extraordinary powers to the Secretary of Transportation under an assumption that a dominant airline has used majority-in-interest clauses and long term leases so as to prohibit competition at these hub airports.

Mr. Chairman, the facts simply do not support any such conclusion that majority-in-interest clauses have been used as a competitive barrier at airline hubs. As you know, majority-in-interest clauses are used in the airline/airport contracts to prevent the inclusion in airline rate bases of the cost of constructing excessive or unnecessary capital projects. An approval of a project under a typical majority-in-interest clause requires both a numerical majority of the carriers representing a majority of either a percentage of leased space or a certain percentage of airport operations. The majority-in-interest clause protects a carrier from the monopolistic behavior of the local airport operator. It gives the airlines a voice in how their money will be spent by making the airlines part of the decisionmaking process. As the Department of Justice said in its recent letter to Senator Hollings, ". . .carriers that finance airport improvements have a legitimate interest in exercising some means of control over how their funds are spent and protecting the value of their investments."

Delta surveyed all domestic airports that we currently serve, and we are not aware of any airports within the last two to three years that have not been able to undertake a major project as a result of a majority-in-interest clause. The facts simply do not support the suggestion that majority-in-interest clauses have been used to prevent the construction of airport expansion needed to permit additional competition, or that they are otherwise anti-competitive.

The other alleged barrier that the Section 411 provision of this bill seems to address is the long term lease for airport facilities. It is suggested that such leases are used to deny access to new entrants either by locking up space or through excessive charges for subleases. We strongly disagree.

After deregulation, Delta inaugurated services to thirty-one domestic cities. We have not experienced any significant problems in obtaining gates, ticket counter space or other important airport facilities at any of these airports. We also are not aware of any other carrier that desired new entry space at the Atlanta Airport or any of the other cities we are privileged to serve that could not obtain such space. It therefore appears to us that this is another issue where the problem is more theoretical than real.

Long term leases provide benefits to both parties, and the terms and conditions for lease arrangements should be a matter resolved between airlines and airports without Federal Government interference. It would be unconscionable to require an airline that has made a long term financial and economic commitment to a given airport to be forced to sublease its gates to another carrier on an uneconomic basis. To again quote the Department of Justice in its letter to Senator Hollings, ". . .artificial limitation of lease duration is not advisable."

PASSENGER FACILITY CHARGES

Delta recognizes the fact that the 8% ticket tax may not adequately provide resources needed for the many airport capital projects that will be needed in the future. While we are willing to consider augmenting the user fee revenues to finance airport development outside of the federal program, we believe that the question of airport funding should be addressed only as an integral part of overall decisions made during reauthorization of the program regarding the use of the Aviation Trust Fund. Additionally, any future funding mechanism that permits local authorities to use funds derived from the local level must maintain eligibility, airport retention and airline consultation requirements set forth today under federal laws and regulations. We must insist the airlines continue to play a major role in how these monies are spent in the future.

Unfortunately, the passsenger facility charge proposal contained in S. 1741 does not address these issues and establishes a process that would probably force airlines and airports into an adversarial posture before the Department of Transportation.

SLOT ALLOCATIONS

As you may recall, Mr. Chairman, Delta opposed the buy-sell provision prior to its adoption in 1986. We felt strongly that the government's efforts should be focused on the need to expand capacity and to eliminate artificial constraints including slot removal, and we continue to urge that this be the primary focus of the government's attention. At the time the buy-sell system was created, however, we felt that acceptance of such a regime would hinder progress in this area, as the basic high density program itself has done for decades.

Since its inception, Delta has not bought or sold slots at any of the four high density airports. We have traded slots at several of these airports, but we have not used this process for financial gain. We do not believe that Delta owns these slots and we do not reflect a book asset value for them on our balance sheets.

Nevertheless, we have found that the buy-sell rule has been an efficient allocator of scarce resources at these airports. This system has allowed airlines to develop services to hubs and non-hubs consistent with market demand. We believe it would be unwise to replace these market forces with government regulation and engage in a process of substitution whereby the Federal Government decides which communities deserve service to any of these four airports. That would be stronger economic regulation than existed prior to 1978! Is the system made fairer and more competitive by suggesting that customers from Birmingham, Alabama or Charleston, South Carolina can no longer enjoy nonstop or single plane service to the Nation's Capital in order to accommodate the needs of communities such as Phoenix, Arizona or Omaha, Nebraska? Let market forces decide!

Before the government decides to replace the existing system with an alternative allocation scheme, we believe it ought to examine the following questions:

1. Should not the basic, supposedly "temporary" high density rule itself be reexamined (for example, by adding a definite "self destruct" date) so that attention will have to be focused where it should be, on expanding capacity at these four cities in order to better accommodate new entrants, small incumbents and service expansions?

2. If such a review concludes that the perpetual retention of slot controls is necessary for safety, facility or environmental reasons, then should not the Federal Government look at how all the slots available at these airports are being used and make decisions that maximize the public interest?

In closing, Mr. Chairman, I want to thank you again for this opportunity to appear today to provide Delta's views on the competitive state of the airline industry. I shall be glad to answer your questions.

DELTA AIR LINES, INC.
GENERAL OFFICES
HARTSFIELD ATLANTA INTERNATIONAL AIRPORT
ATLANTA, GEORGIA 30320-6001 U.S.A.

December 18, 1989

The Hon. Wendell Ford
United States Senate
Washington, D.C. 20510

Dear Senator Ford:

This responds to your letter raising the following questions with respect to S. 1741, and my testimony before the Committee on November 8, 1989. Please let me reiterate our appreciation for your strong interest in these important issues and the opportunity you are providing for Delta to present its views.

1. QUESTION: The bill proposes ending the practice of code sharing to increase competition among the small carriers and to provide travelers with more choices. Your testimony says that code sharing has been beneficial to the traveling public and to the industry. Could you elaborate?

Code-sharing between major carriers and their commuter partners is beneficial to the traveling public and to the industry in a number of respects. Let me first address the public benefits.

Code-sharing provides travelers to and from small communities which cannot support service by large aircraft with the equivalent of one-carrier service to points throughout the nation. For example, a passenger utilizing a Delta connection carrier out of a smaller community enjoys the following benefits: (a) one-time check-in in each direction, at which time boarding cards are received for both the commuter carrier portion and the Delta portion of the journey; (b) convenient reservations and ticketing services performed by one carrier; (c) single baggage check-in in each direction, just as is true of connecting travel where both flights are operated by Delta itself; (d) coordinated schedules, providing time-saving, convenient direct connections; (e) special fare arrangements; and (f) service quality enhancement by Delta.

Let me elaborate on the latter two points. In the case of Delta's Connection Carriers, code-sharing is accompanied by special tariffs which, in most cases, result in lower fares than would otherwise be the case. These savings are produced in two ways. First, the Delta Connection code-sharing arrangement involves the provision of various services by Delta to the smaller carrier, such as reservations services, publication of the commuter carrier's schedules in Delta timetables and CRS displays, joint advertising and promotions, ground handling by Delta for the commuter, and the sharing of facilities at some common airports. On the other hand, the Connection Carriers help generate additional traffic which is fed to and from Delta's flights in a coordinated, efficient manner.

These features result in a number of efficiencies for both Delta and the commuter, which help control costs and which, in turn, help both carriers keep fares as low as possible. In addition, Delta Connection code-sharing is accompanied by the filing of special through fares just as if both legs of the journey were provided by the same carrier, in contrast to a "sum-of-the-locals" fare construction. In most instances, this results in a lower fare than the combination of local fares that would otherwise apply. For example, Delta and the Delta Connection Carrier, ASA, publish an unrestricted one-way coach fare from Asheville, North Carolina (a point not served by Delta, but served by ASA) to Boston (via Atlanta) of $297. If this through fare, which is a direct result of the code-sharing relationship, did not exist, the local unrestricted coach fare would be constructed by adding the local Asheville-Atlanta coach fare ($120) to the local Atlanta-Boston fare ($331) and would total $451 or $154 higher than the current fare. Besides obvious dollar savings for the consumer, the through fare enables another carrier (Delta) to compete on an equal fare basis with American, USAir, and Eastern, which also offer the $297 fare.

With respect to quality enhancement, Delta does not own its Delta Connection Carriers and they do operate independently under their own standards and guidelines. Accordingly, Delta does not control or attempt to control the commuter carriers' operations. Nevertheless, Delta cooperates closely with these carriers and closely monitors their operating performance in an effort to assure that their quality of service is consistent with Delta's own standards. If a complaint is received by Delta with respect to the service provided by a Delta Connection Carrier, Delta works directly with that carrier both to resolve the immediate complaint and to encourage the commuter to avoid a repetition of the problem.

Overall, from the public's standpoint code-sharing between major carriers and commuter carriers--at least the Delta

Connection brand--has expanded and unified the national air transportation system, bringing small and medium size communities into much closer association with, and providing them greater access to, the national system than would otherwise be possible.

Turning to the industry, the primary benefits have flowed to the commuter carriers. There is also, of course, significant benefit to major carriers like Delta because the commuter carriers operate a type of "feeder" service to and from the major carriers' hubs. But the reverse side of that same coin is a tremendous strengthening of the commuter carriers themselves which, in turn, has enabled them to significantly increase the degree of industry competition. Many of the commuters are larger than were the major and national carriers only a few years ago, and competition among them is keen. For example, traffic to and from a particular small community today can often move via a variety of commuter carriers, sometimes competing to the same hub, frequently competing over different hubs, and in a number of instances, competing in both ways. Without the strengths provided by Delta Connection type code-sharing, much of this competition would be impossible. As a consequence, overall competition in the industry is significantly increased by code sharing.

Moreover, some of the code-sharing commuter carriers are enabled, by the strengths provided through the code-sharing process, to compete vigorously with pre-deregulation, major carriers. For example, Comair competes at Huntington, West Virginia with USAir for traffic that can move either on Comair to Cincinnati for direct connections to Delta, or on USAir to Charlotte for connections there. Without code-sharing, Comair would not be able to mount this type of direct competition, and USAir's Charlotte hub would to that extent be shielded from competition. Similar patterns are repeated throughout the Comair Cincinnati and Orlando systems, and this type of service demonstrates strong commuter-major carrier competition that exists (in addition to the extensive commuter-to-commuter competition) for the movement of traffic over different hubs.

In short, code-sharing and hub-and-spoke systems greatly benefit the public, strengthen the carriers, and intensify industry competition. Legislation that terminated code-sharing would weaken, not increase, competition.

2. QUESTION: How would you assure market access to new entrants in today's airline industry?

With respect to access by new entrants to today's airline industry, the major impediment is the inadequate infrastructure, both air space capacity and, in certain instances, airport capacity. These restraints not only hinder new entry but also impede the enhancement of competition by existing carriers.

As set forth in Delta's testimony, most of the alleged barriers to competition have not in fact retarded or inhibited new entry, and governmental attempts to stimulate entry artificially would inevitably (by impeding free market forces in ways not envisioned by the present antitrust laws) have serious side effects; for example, they would diminish the extensive competitive benefits that have been realized under deregulation. If sufficient air space and airport capacity can be provided, and if market forces are not artificially restrained by new legislation, competition (including competition from new entrants) will insure the continued development of air service to meet the public's needs.

Economic deregulation in 1978 removed most of the old governmental restraints on competition and new entry. The antitrust laws now apply fully to the airline industry as they do to other economically unregulated industries, and therefore work to prevent undue monopolization or restraints of trade; Congress should continue to insist that the Department of Justice remain vigilant in enforcing these laws. In this airline industry environment of decreased economic regulation except for intensified application of the antitrust laws, the principles of economics and the demands of the traveling and shipping public have been and are free to shape the industry, its service, and its fare options. Competition has assured the quality and variety of air service most desired by the public. The unequivocal benefits of having marketplace demands shape the system over the last ten years must not be artificially disrupted; it would be a tragic mistake to adopt reregulatory provisions such as those set forth in S. 1741 in an attempt to artificially stimulate or protect new entry.

Imperfections always exist in a free market, but inefficiencies and imperfections always abound in government-regulated markets. The peoples of Eastern Europe, the Soviet Union and numerous other countries are now discovering this economic truth! Any fair appraisal of airline deregulation will lead Congress and everyone to conclude that its benefits far outweigh any imperfections. Hence, no governmental regulation nor any new regulatory legislation is needed to artificially stimulate entry, especially when any such legislation would very likely distort competition and make it more difficult for marketplace demands to be met. All that is needed is (1) that the Department of Justice continue vigorous enforcement of the antitrust laws; and (2) most importantly, that Congress insist upon and provide for increased air space capacity and encourage the development of new airport capacity when needed.

3. QUESTION: You mention that hubs like Cincinnati have brought a number of economic benefits to the communities. Could you elaborate on that?

Every hub city benefits tremendously--economically and otherwise--from the hub-and-spoke system. Before explaining how a hub itself benefits, however, I would like to emphasize that the system also greatly benefits the spoke cities that are connected to the hubs. As I indicated in my written statement of November 8, 1989, and the oral statement of that same date, as well as above, the hub-and-spoke system has resulted in increasing degrees of competition among commuter carriers, and sometimes among commuter and major carriers, in an effort to move traffic to and from the spoke cities via various competing hubs (and sometimes in competition to and from the same hub). This has improved service to a great number of smaller communities throughout the nation that are now sometimes characterized as "spoke cities," which in turn has aided economic development in those cities.

But the most obvious, although not necessarily the most important, benefits of the hub-and-spoke system can be seen in hubs themselves, like Cincinnati. The benefits fall into three different areas. First, an airline hub operation at a point like Cincinnati results in a greatly enhanced pattern of nonstop services for the city--far beyond the pattern of service which the local traffic-generating strength of the city could otherwise support. The enhanced service pattern is made possible by the connecting traffic moving through the hub to and from the spoke cities, and which is available at the hub only because of the hub-and-spoke system. If that traffic were to connect elsewhere, and the carrier had to rely only on local origin and destination traffic to and from the hub, the service pattern would decrease manyfold.

For example, Cincinnati boarded 3.5 million local passengers during the year ended June 30, 1989 and had a total of 317 daily departures (including 144 commuter flights). The next largest city in terms of passengers--Austin, Texas--at 3.6 million, but not a hub, had a total of only 85 daily flights.

This enhanced service pattern for the hub--far beyond the basic needs of the city itself--is of tremendous benefit not only to passengers, but to commercial and industrial interests in each hub, to freight shippers, and to the U.S. Postal Service.

Second, the enhanced operation by the hubbing carrier or carriers which is made possible by the hub-and-spoke system at a point like Cincinnati significantly increases the point's ability to attract new business and industry, as well as national conventions and other similar meetings. With nonstop and frequent flights to numerous destinations, a hub city also becomes increasingly attractive for corporations seeking to establish regional offices or to relocate headquarters facilities. All of this, plus the hub carriers' own expanded operations, results in considerable added employment at the hub which would not otherwise exist. This not only increases employment per se, but also greatly increases payroll and payroll-related benefit payments in the local community.

Third, the expanded airline operation made possible at the hub results in significantly increased carrier expenditures at the hub city not only for payroll and payroll benefits, but for utilities, passenger food, commissions, rentals, landing fees, aircraft fuel, other supplies, and even local taxes, among other expenditures. These expenditures constitute a tremendous boost to the local economy of each hub city.

Assessments of economic impact from payroll and the type of expenditures enumerated above normally include application of a 1.5 multiplier effect in order to account for the increased economic impact resulting from the circulation and recirculation of the sums spent by the airline or other entity being studied. Delta has made an assessment of the annual economic impact of its own hub operations at the following cities. The numbers set forth to the left of the slash mark in Column (1) of both of the two tables below are Delta's actual expenditures for payroll, payroll benefits, and the expense items enumerated above, plus an "all other" category to reflect expenditures for miscellaneous, smaller items. The numbers to the right of the slash in the two column (1)'s are the total, annual economic impacts after application of the 1.5 multiplier effect.

Two things should be noted about the following numbers: First, they do not reflect yet another benefit to the hub city--added expenditures by passengers transiting the airport, which would not be spent at the hub city in the absence of the hub-and-spoke operation. Secondly, the numbers below reflect only Delta's own operations at its hubs. In all cases, other airlines also expend considerable monies at the hub--as a result of operations that are enhanced in some cases by Delta's own hubbing operations--and in some of the cities listed, there is another full-blown hub operation by a Delta competitor.

First, to illustrate the impact that establishment of an airline hub can have on the economy of the hub city, I set forth immediately below numbers for the Cincinnati area both before (1986) and after (1988 or 1989 as indicated) the development of Delta's hub there beginning in December of 1986:

	(1) 1988 Actual Annual Expenditures/Total Annual Impact With 1.5 Multiplier		(2) Total Employment		(3) Payroll
1986	$70 million/$105 million	1986	771	1986	$22 million
1988	$208 million/$312 million	1989	2,894	1989	$94 million

The following table sets forth current data for a number of Delta hubs, showing the highly positive economic impact of hub operations by Delta at each point:

Delta Air Lines, Inc.
Hub Economic and Employment Impact

Cities	(1) 1988 Actual Annual Expenditures/Total Annual Impact With 1.5 Multiplier	(2) Total Employment (1989)	(3) Payroll as of 11/30/89
Atlanta	$1,770 billion/$2,505 billion	22,374	$875 million
Boston	188 million/$282 million	2,194	88 million
Cincinnati	208 million/$312 million	2,894	94 million
DFW	449 million/$673 million	5,941	231 million
Los Angeles	324 million/$486 million	3,858	151 million
Orlando	90 million/$134 million	829	24 million
Salt Lake City	302 million/$453 million	4,060	160 million
TOTALS	$3,230 billion/$4,845 billion	42,151	1,623 billion

Delta appreciated the opportunity to present the Committee with its views on the issue of airline competition and S. 1741. Please let me know if you have any further questions relative to Delta's testimony.

Sincerely,

James W Callison

James W. Callison

JWC/rta

Senator FORD. Thank you very much, Mr. Callison.

While I see benefits derived from deregulation, I am bothered by statistics which indicate that in 1988 I guess 90 percent of the industry's traffic was carried by only, I believe, eight carriers.

Some carriers have significant problems, some are and will be plagued by buyout attempts. Would it worry you if the number of carriers shrank to five or six? And would that circumstance improve or diminish competition?

Mr. CALLISON. I am not sure it would terribly bother me, and I am not sure that at one point in time it would have terribly bothered a pure economist like Alfred Kahn.

I can remember back in the deregulation debate days predictions were made that deregulation in fact would cause a concentration in the industry and that you would wind up with far fewer large carriers than you had under regulation prior to 1978.

I cannot recall where he said this, but I am morally certain, I am 99 percent certain, he did say that you can get better competition sometimes and lots of times, as a matter of fact, you can get better competition from a smaller number of financially strong carriers than you can from a larger number of financially weaker carriers.

Now, we had a larger number of financially weaker carriers prior to deregulation. Deregulation has caused some concentration, but it is only relative, because even before deregulation the bulk of the traffic was carried by a relatively few number of large carriers.

We have had some concentration, but we have also had a tremendous increase in productivity and efficiency in this industry. We have had a much better rationalization of how our airplanes are scheduled and utilized and how they are attuned to market size.

We have spread out. We have a much more expansive national air transportation system, whereby most cities of significant size have better access to that system than they had prior to deregulation.

So overall I think we have developed a better system through some of that concentration and, while certainly we do not want to get down to too small a number, some further reduction I do not think would necessarily be bad, as long as the carriers that exist strongly compete, as is true in a number of other industries, where the number of entities is fairly small.

Senator FORD. What you are saying is that better financial stability would give an airline an opportunity to be more competitive than less?

Mr. CALLISON. It could, yes. I am not saying it necessarily would. The question really is what the market forces are going to dictate, and that is what Congress said in 1978 should be done. Market forces should determine where airline resources are used and how they are used. It is just going to have to depend what those market forces say is best for the public.

Senator FORD. You mention that hubs have brought a number of economic benefits to communities. Would you elaborate on that?

Mr. CALLISON. Well, the hub system, as you know, Mr. Chairman, was really a system developed by Delta Air Lines in Atlanta back prior to deregulation. It was developed because the Southeast after World War II was characterized by a number of fairly small- and medium-sized communities that really could not support much service directly to other communities in the country.

So to provide them with good direct on-line service, one-carrier service, we developed that hub system in Atlanta to bring passengers and shippers from and to, of course, but from those small communities into Atlanta, transfer them, and get them out to where else they wanted to go.

Now, what has happened under deregulation is carriers are free of the restrictions of the old route certificates that were granted by CAB. They could look at what Delta had done in Atlanta, what American had started to do in Dallas-Forth Worth, and they could emulate that, and they realized that was an extremely efficient way of connecting all the cities in the country.

And that is what has happened, and we have gone from four hubs prior to deregulation to 35 today. We have gone from one in the Southeast to eight in the Southeast. As a result, cities all over the country, like Charleston and Columbia and Savannah in the Southeast, the area with which I am the most familiar, today have multiple choices.

They do not have to go through Atlanta. They can go to Charlotte, they can go to Dulles Airport, they can go to Raleigh-Durham or Nashville or down to Orlando. They have multiple choices of ways to get where they want to go and multiple fare options as a consequence.

That has multiplied around the country and those hub systems compete with each other for the very same traffic flow, so that if you are sitting in Columbia you have those options and that competition.

So by and large, the hub system has expanded service, it has expanded service options, it has expanded price options, and I think made the whole system better and more productive and more efficient.

Senator **Ford**. I know particularly about the greater Cincinnati-Northern Kentucky hub of Delta, and I have observed that now for several years and I have watched the improvement in the airport. I have watched the ability to have funds to build another runway. I have had an opportunity to watch the financial benefit to the community.

The Northern Kentucky Chamber of Commerce stated in a recent letter that Delta's hub there brings approximately a billion dollars a year into the community. Now, to this country boy that sounds pretty good.

And I am not sure that all hubs have done the same thing, but I cannot see a hub whose community has not been improved.

Senator **Danforth**. How about Kansas City?

Senator **Ford**. I do not know. That is your area. You can tell us about that in a minute. But the only thing I can talk to you about is how great it is for us.

Mr. **Callison**. Thank you, Mr. Chairman.

Senator **Ford**. Well, when you get off base I will do what I am supposed to do.

Mr. **Callison**. I have no doubt.

Senator **Ford**. With the airline industry achieving, I think it is, an overall profit, average profit, below five percent, the industry has somewhere between $12 and $15 billion in aircraft orders on the books. I guess Delta has a low debt to equity ratio. Will you be able to pay for your aircraft on order out of Delta's projected future income, assuming that the profit margins of today remain at this level?

Mr. CALLISON. No, sir, we would not. There was a time historically when we could have done that. But today, even though we are a fairly successful airline, the profit margins in our industry are relatively low and Delta's is relatively low, much lower than they are in most other industries.

I think that says something about this industry's efforts to pass along good fare savings to the public.

During the 10 years since deregulation starting with fiscal year 1979, our average net profit margin, which is a measurement used in lots of other industries, has been only 3.7 percent. We have done a little projecting out the next 3 years under our equipment program, which is fairly extensive because we are trying to get in modern aircraft and upgrade to stage three and get noise-compatible aircraft and so forth.

But looking out those 3 years, we will have to have an average net profit margin of 11.8 percent, roughly 11.8 percent on our gross revenues. Historically, we have never gotten anyplace near that, and so we will have to, of course, borrow lots of money or otherwise finance those aircraft.

We cannot do it entirely through internally generated funds with the profit margins, the low profit margins that this industry experiences.

Senator FORD. That gets me around—I will not ask you to answer this, but that gets me around to my leveraged buyout legislation that Senator McCain and I and others are very concerned about. If under these circumstances where your percentage of profit, 3.7, and it would take about 11-point-plus if you would pay it from the cash flow. That means you have to borrow money.

You have, I suspect, pretty good orders on the books for new aircraft, stage three, quieter, so you get out of the noise problem. And then if you were purchased with a leveraged buyout and there is a high percentage of payback, 15 or 18 percent on some of the investment that required a guarantee, then you find foreign money used for up-front purchase and equity.

And if under those circumstances something happens that you cannot meet those payments, which are high, well beyond your 11 percent projected and almost five times what your profit is now, I find a foreign lender may get a good airline at a fire sale if you go down.

And number two, you are prevented from securing the new aircraft. You would not have the money to do that, and therefore we get into the aging aircraft or aging fleet problem, and then we get into safety. Though we may not curtail maintenance or that sort of thing, just the age of the aircraft at some point may be a problem.

So I have got a lot of concerns about the industry, and I hope we can work to some conclusion that will be helpful to all.

I thank you for your testimony.

Mr. CALLISON. Well, I would like to commend you, Mr. Chairman, for your leadership in that area, because we have a lot of those very same concerns. And if you look around this industry, the carriers that have really succeeded have been the ones with relatively low debt, and the ones that have struggled and had the troubles by and large—no rule is universal, but by and large—have been carriers that have had high debt.

So your concerns are very well placed, I think. And while nobody likes to see additional regulation of any kind, that is not really regulation that you propose. It meets, I think, some very serious concerns in this industry.

Senator FORD. The financial community that testified in this room not too long ago said that, if that bill was passed, it would give more substance to the financial institutions as it relates to their desire to purchase, because we would have gone through certain steps that, when it finally was arrived, the security would be enhanced considerably.

So the testimony—even Secretary Skinner, who is now, I understand, opposed to it because he is a good soldier and the administration is against it, and I do not fault him for being a good soldier, said it would make it easier on him and more efficient. So we will have to wait and see.

Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Callison, I will make a few comments. I would be glad to hear any response you might have, and then I have a couple questions.

First of all, a hub system is a great thing. I think that it is a natural outgrowth from a deregulated environment.

Our problem, Mr. Callison, is not with hubs per se. Our problem is, and this position is supported by concrete evidence presented to this committee, that where a hub is concentrated and dominated by one airline, airline fares are higher. That is a disservice to the passenger.

Now, I know you disagree with that. I have two choices: agree with you or agree with several different studies which have been conducted by governmental agencies, including the investigative arm of the Congress, that say otherwise.

I would be glad to see your figures that dispute the findings of the GAO and the Department of Transportation.

Clearly, you know what Section 411 does with the DOT, do you not? It is a response to a complaint; it is an administrative hearing in response to a complaint, right? Is that your understanding of section 411 of the Department of Transportation?

Mr. CALLISON. By and large that is true, Senator. But it also, I think, gives the Department some power to investigate unfair and deceptive practices on its own motion.

Senator MCCAIN. In response to a complaint, right?

Mr. CALLISON. I am not sure it always has to be in response to a complaint.

Senator MCCAIN. It is far different from the oversight that the FTC exercises over every other deregulated interstate industry in this country. It is far different. It is far, far different.

So how you can make an argument that it is duplicative frankly escapes me.

You have said that it was not "equitable" to redistribute slots so that new entrants could fly into slot-constrained airports. I did not hear you protest in 1985 when the Department of Transportation gave you these valuable assets, which you now count as part of the overall value of your airline.

Finally, I think that I am astonished to hear you say that some further reduction in the number of airlines might be appropriate. We just saw Braniff Airlines go under for the second time, and Presidential Airlines recently went under.

We now have a grand total of two post-deregulation airlines still in business. We see now basically five airlines that seem to have the financial strength to compete internationally when that day arrives, some time around 1992.

So for you to somehow blithely state that further reduction in the number of airlines may be something that we should not be concerned about very frankly astonishes me. It may be good for Delta Air Lines. It is certainly not good for the consumers and airline passengers of America; we have clear evidence from governmental agencies that where one airline dominates, whether it be a route or whether it be a hub, those fares then go up and the passenger pays.

I would be glad to hear your response to all of those.

Mr. CALLISON. Senator McCain, I do not believe I said it would be appropriate for the number of carriers to be reduced. The Chairman asked me what I thought would be the effect on competition, as I understood it, if the number of carriers were to go down to a smaller number, and I was trying to respond, both on my behalf and what I recalled some of the economists saying, that that would not necessarily result in an diminution of competition or in an elimination of competition or in bad competition.

That is the context in which I tried to answer that question.

Senator MCCAIN. Frankly, I do not understand the logic that, when you lower the number of competitors, you do not increase an anti-competitive atmosphere.

Mr. CALLISON. Because any industry shakes down to a certain number of entities that can most effectively operate the competition in that industry. And free market forces are going to determine that if the Government allows that to happen.

Senator MCCAIN. If they are indeed free market forces.

Mr. CALLISON. It may be more carriers in certain circumstances, Senator, and it may be less in certain circumstances. But I would just respond to say that a decrease would not necessarily mean less effective competition.

Now, you referred to the GAO study. I have a great deal of respect for the GAO. It is a fine organization. But I also have a lot of problems, which I cannot tick off for you here today—I do not have it in front of me—with that study.

That study had a lot of shortcomings. It looked at fares only. It did not look at costs, it did not look at marketplace factors that contribute to those particular fares. It did not include all the hubs that we thought should have been studied.

There were just a lot of deficiencies in the study, and there are other studies that showed different results. And I am not saying and I do not think anyone is saying that hub fares are not probably somewhat higher than other fares, but there are reasons for that.

In the first place, a hub predominantly provides non-stop service, many long-haul, if it is a mature hub, and short non-stop services. Those fares generally are higher because they are higher quality, just like a Cadillac costs more than a Chevrolet does. So there is a reason for that in certain circumstances.

Senator McCAIN. Mr. Callison, the study shows that only where there is one dominant airline is the fare higher, not just higher fares throughout any hub, my friend.

Mr. CALLISON. But they carefully selected the hubs they studied. That is what I am saying. They did not compare all hubs. They picked out just certain ones to study.

Furthermore, as a hub is developing, and some of those they were talking about were developing, you are going to have more short-haul segments in there, and those cause fares to be higher because it costs more to operate short hauls than it does longer haul flights.

So I am not saying hub fares are not higher. I am not saying they should not be somewhat higher. They probably should be somewhat higher than multi-stop or connecting service which operates in other markets.

That is not unusual pricing. That is rational pricing, I think.

Senator McCAIN. Thank you. Thank you, Mr. Callison. I think you have provided us with a lot of good information.

Thank you, Mr. Chairman.

Senator FORD. Senator Danforth.

Senator DANFORTH. Well, Mr. Callison, I just want to say at the beginning of my time, I am not sure that I am as ready as some to sing hosannahs to the wonders of hubs. They can provide certain benefits. Also, as Senator McCain has pointed out, they create a much greater increase in fares than is true in non-hub airports.

But I am particularly concerned, as I pointed out to Senator Ford, that the situation in Kansas City has just been a total disaster. I mean, here is a city that has been the hub airport for Eastern, the hub airport for Braniff. And now, after the bankruptcy, the number of flights, I am told, is about half of what it was 18 months ago.

People's lives have been disrupted. And so it is not necessarily true. It has to be viewed community by community what the effect of the hub airport is. But in Kansas City these people are really suffering.

Mr. CALLISON. Well, that is true right now, Senator Danforth. But I am not sure that is the fault of the hub system, though. It could be the fault of the carriers that chose to operate the hubs there. It could be a geographical problem.

Now, I am not that familiar.

Senator DANFORTH. Well, it is a situation where the string has just been cut. I mean, the people of Kansas City find out literally in one day that an airline which has a dominant position at Kansas City International is no longer going to fly any planes at all.

I mean: Good morning, how are you doing today; here is the news: No planes are going to be flying by Braniff.

Mr. **Callison**. I understand that. But by the same token, because that particular carrier had a problem I do not think you can use that to condemn the hub system. Now, admittedly maybe there would have been other carriers there, I guess is what you are saying, more carriers there, if you had not had the hub system.

But probably Kansas City would not have had as good a service in the meantime.

The loss today is not because of the way carriers have responded to free market forces. The problem is all the difficulties in which Braniff got itself, including that leveraged buyout.

Senator **Danforth**. Well, I strongly dispute your view that free market forces are at work in the airline industry. If that were the case, that this is simply free market, that what deregulation went from was a regulated market to a free market, then I would be the first one to agree with you.

That was our intention when we deregulated the airlines eleven years ago. But that in fact has not been the case. The fact of the matter is that the initial surge of new entries collapsed. Now eight airlines control 90 percent of air transportation; at hub airports, the dominant airlines' fares have increased two to three times the national average.

I do not see anything that is competitive or free market about majority-in-interest clauses. Now, you say it gives an airline a voice. Yes, it gives an airline a voice at an airport.

It gives an airline not only a voice, it gives them a veto power, does it not?

Mr. **Callison**. No, sir.

Senator **Danforth**. It says that the airline can veto the expansion of that airport so that competing airlines cannot come in.

Mr. **Callison**. That could happen only where one carrier had such a majority, and there are some instances where that is true. But by and large, those majority-in-interest clauses work as a majority. It is a majority of the interests of all the airlines serving that point.

Senator **Danforth**. Well, let us take St. Louis, for example, Lambert. TWA has 82 percent at Lambert. That is a majority.

Mr. **Callison**. That is a majority in that case, that is correct.

Senator **Danforth**. And therefore they can veto, in effect, the entry of other airlines.

Mr. **Callison**. No, sir. They can veto the city's building facilities for which that carrier is going to have to pay. If St. Louis wants to build facilities outside of that mechanism on its own, with its own funds, it can do that.

There is nothing that majority-in-interest clause can do to stop that. All it says is, do not load those expenses on TWA without giving me, TWA, a voice in that development.

Senator **Danforth**. The veto power.

Mr. **Callison**. And as a practical matter, very seldom is an airline going to stop a development. What it is going to do is to help shape the size and scope of it so that it makes rational economic sense.

But the city, if it wants to be irrational, can go out and build its own facilities with its own funds, however it wants to get that money outside of that mechanism. So it does not give the airlines a veto power.

Senator FORD. Let me interject here. That is similar to what Mr. Beauvais said about Phoenix.

Mr. CALLISON. Yes, Phoenix did that.

Senator FORD. Phoenix did that.

Mr. CALLISON. Yes, for whatever the reason was, they did it.

Senator FORD. They spent their own money and that is America West's hub for all practical purposes. And so the City of Phoenix, without America West being involved at all, spent $100 million or so to expand their facilities. So under those circumstances I think that St. Louis could do the same thing if they wanted to.

Senator DANFORTH. Well, I suppose it could. But I thought, ever since I first came to the Senate, and sometimes to my dismay, that user fees were the ways we were going to finance capital construction in this country. And that apparently is going to be true everywhere except airports.

Mr. CALLISON. Well, it has been true. I am not sure that user fees is exactly the way it has been done in the past. The way it has been done in the past is you have a long-term lease and the airline commits to stand behind those bonds with its payments to the airport, which is a sort of a user fee, that is correct.

But airports are in fact looking for new and innovative ways to fund, and the Government itself is going to have to look for new and innovative ways to fund airports. And as Mr. Beauvais pointed out, there are indeed some airports that are doing it now outside of the old system, and that is fine. There is nothing wrong with that.

Senator DANFORTH. Well, we have proposed the passenger facility charge in this legislation. Do you support that?

Mr. CALLISON. What I said in my statement was that we think that ought to be looked at. We think alternative ways of funding airports have to be looked at, because the eight percent tax and the aviation trust fund——

Senator DANFORTH. But if we are going to do it, clearly we cannot give the dominant airlines the power to veto that expansion, can we?

Mr. CALLISON. Whether you do that or not, you sure do not want to just cut the airlines out of it entirely. And that is almost what the proposal does. It tells the airport and the airlines to go to the Department of Transportation and let the Secretary hear both sides in sort of an adversarial proceeding. He will decide whether a passenger facility change should be assessed or not and, if so, for what.

I do not think that is a good way to do it, either. There are criteria today in the aviation trust fund that involve the airlines in the process, and if you move to a passenger facility charge and let local airports do it that way, all well and good. But you ought to preserve those features that are in the present legislation that let all airlines be involved in developing a sensible, rational, economic development.

Senator DANFORTH. Well, my point is that the majority-in-interest clauses as they are used today as a practical matter are anticompetitive.

Mr. CALLISON. I disagree with that, Senator, because, as I said, we surveyed our system. We cannot find any place on our system in the past 2 or 3 years where an airport wanted to undertake a major development that it was not able to do so.

There have been a few cases where we have said, you are overexpensive, you are wasteful.

Senator DANFORTH. I do not know what you have done in your own airline. But I can say in my opinion it is inherently anti-competitive to give a dominant airline a veto power on airport expansion, and that is what these clauses do.

Mr. CALLISON. The alternative would be to give the city sole control as the monopoly owner of the airport and charge the airline whatever it wants to, for whatever it wants to build. And that gets back to the passengers and fares.

Either way maybe is not perfect, but the majority-in-interest clauses, as I said, do bring the airlines and the airports together to work in a partnership.

Senator DANFORTH. The dominant airlines.

Mr. CALLISON. Well, they do it all over the country, in cities where you have dominant carriers and cities where you do not have dominant carriers. It has worked extremely well for many, many, many years.

Senator DANFORTH. All right. Well, we simply disagree on that. It has worked well for Delta.

Mr. CALLISON. And for many other carriers, not just Delta.

Senator DANFORTH. Well, for seven other carriers.

My view is that long-term leases are inherently anti-competitive. Do you disagree with that?

Mr. CALLISON. I do. You look at a city like La Guardia, where we built a $100 million terminal because the terminal facilities at La Guardia were pretty outdated and pretty bad, they needed something to be done with them. We committed $100 million to develop that unit terminal for Delta Air Lines up there.

We have built gates, we have done all kinds of things up there. We cannot afford to do such things unless we get some kind of a long-term commitment, because you are talking about millions and millions and millions of dollars.

Now, we make those gates available to others. Northwest uses some of those gates. Other carriers have as well. But our long-term lease really helps the airport and it really helps the carriers develop the facilities that are needed.

Senator DANFORTH. Why is it not inherently anti-competitive for an airline to control the gates through long-term leases, to decide who can use those gates and when, if at all. And furthermore, why is it not anticompetitive for that airline to have a veto power over airport expansion?

Why is that not inherently anti-competitive?

Mr. CALLISON. Because it really does not often work that way. Lots of airports where you have a long-term lease now have preferential use clauses or use it or lose it clauses, so that the carrier who has that gate, if he is not going to use it full-time, cannot prevent another carrier from coming in.

We almost noplace on our system have more gates than we can use and use relatively full time. Now, there are some smaller cities where we share gates. New cities we have gone into, we always share gates because we could not get our own facilities there first. Ultimately we hope to.

It is not as exclusive and it is not as anti-competitive as it has been painted, I am afraid, to you, because in actuality carriers do share facilities, carriers do help each other out, new entrants do go into airports, and new facilities are in fact built in a rational economic way.

Senator DANFORTH. Well, there used to be a radio character in St. Louis named "Miss Blue," and her slogan was "All is well." And I think that that is your basic statement. In your view, all is well.

Mr. CALLISON. Basically, yes, sir, that is correct. I do not think we need new legislation.

Senator DANFORTH. I think from your standpoint it is. From your standpoint "All is well." But I do not believe that all is well for the traveling public, because I do think we have a monopoly situation in air transportation, which is anti-competitive. And I think that this bill addresses it, but that is a difference of opinion.

Mr. CALLISON. Yes, sir. Thank you.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. How did the Brookings Institute come up with the figure that they are saving passengers or consumers $10 billion a year, in air fares?

Mr. CALLISON. Yes, the $10 billion is a year, $100 billion over the time period that they studied, that is correct. That is an inflation-adjusted number.

Senator FORD. 1988 figures.

Mr. CALLISON. Exactly how they did that, Mr. Chairman, I cannot tell you. But what they have done is compared what would have been spent under the old system with what is in fact—how much less is being spent under the deregulated system that we have today, with market forces governing the industry, and they computed that is how much was saved.

Exactly how they did that I cannot tell you.

Senator FORD. Well, on page 9 of your statement I read, and I have been looking for it, you say $10 billion annual savings, together with the high volume of discount seats available, underscores the great number of fare options which deregulation and the hub and spoke system has provided the public.

That is a pretty good hunk of money that is being saved, and I do not think anyone wants to refute the Brookings Institution. I do not know whether they are too conservative or too liberal or neutral.

Mr. CALLISON. They are fairly conservative normally.

Senator FORD. Well, I kind of thought so. Sometimes I trust them better than GAO.

But who would you as an airline sign a contract with when you started a hub?

Mr. CALLISON. When we start a hub?

Senator FORD. Yes.

Mr. CALLISON. Well, in most cities, of course, you would lease space from the airport authority. Now, you cannot always get space from an airport authority because deregulation has so expanded the air transportation system and so increased the demand that some of those facilities are pretty crowded.

So sometimes—we have had to do this in Buffalo and Rochester and Syracuse and Albany—you have to initially get space from another carrier, and other carriers are usually very willing to make that space available.

Senator FORD. But the airport authority is the authority that makes the judgment for the political arena of that community?

Mr. CALLISON. Oh, yes, sir. Yes, sir.

Senator FORD. Now, if that airport authority makes a mistake, who do you blame? The industry or the airport authority?

Mr. CALLISON. If they make a mistake in terms of too many facilities, you mean, for example?

Senator FORD. Well, let us just take Braniff, for instance. We had that brought up a few moments ago. All of a sudden they are gone. Well, Braniff has had a hard time.

Now, are we to blame the total industry for the problem of Braniff and the airport authority in Kansas City?

Mr. CALLISON. No, sir, and I do not think I sounded very sympathetic to Senator Danforth, but in fact I am with the plight that exists in Kansas City.

Senator FORD. Well, I am unhappy about that, too. But all of a sudden you have got a bill here to remedy that.

Mr. CALLISON. Well, I do not think it is.

Senator FORD. And I do not think the bill will remedy a bankruptcy.

Mr. CALLISON. The problem with Braniff's bankruptcy is not the airport or the airport authority or the airline industry or deregulation. It is the carrier's own management and the way it functioned and operated, and in that particular case a recent LBO which aggravated their problems with heavy debt.

Senator FORD. Well, that is another reason for passing the LBO bill.

But just there is something about blaming the industry, and saying we are not doing a good job and there is no competition out there. So we have an airline that has gone down and there was a leveraged buyout and cash was needed, and the airport authority signed up and gave them the hub or they made some kind of a contract that gave them the authority, and then all of a sudden they financially are gone, and so they just closed their doors.

Now, here we are, as I say, Big Brother was supposed to prevent that or to subsidize it to be sure that you get it back. And neither are going to work in my opinion.

Mr. CALLISON. Well, sir, that is really what Congress concluded in 1978 when it said it would not do that any more.

Senator FORD. I thank you, Mr. Callison.

Mr. CALLISON. Thank you, Mr. Chairman. Thank you, Senator Danforth.

Senator FORD. Our last witness will be Mark Cooper, Research Director, Consumer Federation of America.

STATEMENT OF DR. MARK COOPER, RESEARCH DIRECTOR, CONSUMER FEDERATION OF AMERICA

Dr. COOPER. Thank you, Mr. Chairman.

I wrote in my testimony that, in order to reach sound policy, we have to cut through the rhetoric and smoke of the airlines, and when you write something like that you are never quite sure what they are going to say. But they certainly have filled the room, so let us go straight at it and see if we can cut through it.

Senator FORD. Are you accusing me of smoking too much?

Dr. COOPER. No, no, I did not. It is not you who filled the room with rhetoric, at any rate.

The most frequently claimed benefits of airline deregulation are huge increases in the numbers of passengers and miles flown, resulting in a democratization of air travel. There is simply no truth to the former two claims and very little truth to the latter.

There is little difference in the growth of passengers and passenger miles measured in absolute terms or relative to income and population between the pre- and post-deregulation periods. Income and population are the drivers of growth.

Reflecting this basic continuity, data from the consumer expenditure survey shows that for households reporting an expenditure for air travel as a household expense, which is obviously largely leisure travel, there has been no democratization whatsoever. Low, lower middle, and middle income households accounted for almost exactly the same percentage of households incurring such an expenditure in 1987, which is the late date we have data for, as they did in 1980.

What the representatives of the airline industry have claimed for deregulation reflects income and population growth, rather than deregulation, by a factor of four to one. The claim is far too large.

Now, having observed little change in passenger growth patterns from historical trends, we would expect to find little change in fares from historical trends. Obviously, the factors affecting fares are complex, but when fuel prices and income-related growth in ridership are taken into account the bottom line on fares is that there is probably very little difference between what they would have been under regulation and what they have been under deregulation.

In point of fact, that is significantly what Brookings found.

They are not nearly as low as they could be under competition, nor is service as good as it should be, and that is what has outraged consumers. But the airline representatives of the industry told you today, for instance Mr. Crandall said, since 1988 our fuel prices have gone up, but our fares have not.

He did not tell you what happened to fuel prices between 1984 and 1988. They plummeted, but fares did not track them down.

In the early days, coach fares were increasing and discount fares were decreasing. But of course, with increased concentration discount fares are disappearing. Moreover, discounting has always been directly and closely related to competition.

In 1983, which was of course the heyday of competition in the industry, only one-quarter of monopolized markets had discounts available, while over three-quarters of competitive markets had such discounts. Prices have increased much more sharply in markets served by only one or two carriers than in markets served by a large number, five or more in particular.

Mr. Crandall described for you price discrimination based on customer classes: businessmen pay more because they are willing to pay more. He ignored to recognize price discrimination based on market characteristics. Econometric studies have found, and not only Brookings and not only the GAO, everyone has found, that monopolized markets pay higher prices, by 25 percent or more.

As I demonstrated in my testimony, the pricing pattern that obtained in St. Louis after the TWA-Ozark merger was exactly as predicted by those very detailed econometric studies done by academics.

The extremely high levels of concentration on most routes and the clear demonstration of the correlation between concentration and price raises the fundamental policy issue before us today. Mr. Crandall and again the second consumer from the industry stated a meaningless truism about origin-destination pairs: Since 1978 there is greater competition on origin-destination pairs than there was before that.

Absolutely true. When you had regulation, A, you were not allowed to have a great deal of competition; and B, you did not need it because you had regulation.

The fundamental question is is there enough competition on origin-destination pairs today to replace the discipline of regulation with the discipline of market forces? That is the question, not whether there is more.

Over 95 percent of all city pairs are highly concentrated by the antitrust standards applied by the Department of Justice in its merger guidelines. Over half of all passengers leave from airports where the dominant firm has a market share larger than the leading firm proviso in those guidelines.

The bill before us today has referenced those concepts. Those are the right concepts, whether or not there is enough competition, not whether or not there is more.

The Airline Competition Enhancement Act has identified the right problem and suggested the right solutions. The dominant airlines control access to the stream of commerce through their control and manipulation of computer reservation systems. Those systems are efficient, but they need not be anti-competitive.

The dominant airlines have constructed impenetrable hubs behind whose walls they charge higher prices. Now, concentrating the flow of traffic has improved efficiencies, but it is not clear that the concentration of traffic can only be achieved with the concentration of ownership and control of facilities.

Affiliation arrangements eliminate the chance of regionals growing into serious competition for majors. Code-sharing fools the public and the DOT's implementation of any protections is inadequate.

Finally, the authority for consumer protection and responsibility must lie with an agency whose job that is, not with an agency whose primary job is to protect and promote the industry. The FTC is the right place for these authorities.

We also believe that when shifting that authority we can certainly specify consumer protection rights, as suggested in Senator Metzenbaum's bill.

You will all recall that consumer advocates led the charge for airline deregulation, because they firmly believed and still do that competition is the consumer's best friend. Unfortunately, a decade of do-nothingism by Federal antitrust and consumer protection agencies has denied us the benefits of competition.

We are not asking for a return to regulation, but we demand real competition. In the first decade of deregulation, competition barely had a chance and then it was squelched. This bill takes a step in the right direction to restore competition.

Let me suggest to you that, if Mr. Crandall or anyone else had come up here in 1976 and 1977 and said, well, we are going to have two or three airlines serving most places, but that will be good enough, you gentlemen would never have deregulated looking at such meager, thin competition.

Senator FORD. We would not have believed him.

Dr. COOPER. You certainly would not. But that is what you heard today: One, two, or three is going to be enough and you are going to have to live with it.

Well, what we say is the following: Let us give competition a real chance by getting active policies to promote it, because we still have not given up hope on it. Maybe at some time in the future we will come back and all agree that it cannot work in the industry, but let us give it a real chance.

Thank you, Mr. Chairman.

[The statement follows:]

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee,

My name is Dr. Mark N. Cooper. I am Director of Research of the Consumer Federation of America (CFA) with offices at 1424 16th Street, Washington D.C., 20036. Founded in 1968, CFA is the nation's largest consumer advocacy organization encompassing more than 240 national, state and local consumer, senior citizen, low income, union, farm, labor, public power and cooperative groups representing more than 50 million people.

I appreciate the opportunity to testify before you today on the matter of the evolving structure of the airline industry.

A REALISTIC VIEW OF DEREGULATION IS CRUCIAL FOR SOUND PUBLIC POLICY DECISIONS

At this hearing and any others you may hold on airline deregulation you will hear a great deal from the airlines about the good that deregulation has done. For example, you will hear that air fares are down, enplanements are up and that air travel has been democratized. The airlines will admit to very little that is wrong with airline deregulation.

In reality, the record of airline deregulation is spotty at best. Some of the benefits that are claimed in the name of airline deregulation are simply false. Others have nothing to do with deregulation whatsoever, but were the result of normal internal industry processes or external forces. And, while deregulation has had positive effects, it is also clear that deregulation has had a number of negative effects -- both in absolute and relative terms.

COMPETITION IS THE KEY TO THE SUCCESSES AND FAILURES OF AIRLINE DEREGULATION

The single greatest cause of these negative effects has been the failure of competition to develop. High levels of concentration and integration in the industry have given rise to pervasive anticompetitive and anticonsumer business practices. These include the manipulation of computerized reservation systems, excessive prices imposed behind the walls of impenetrable hubs, anticompetitive affiliations at hubs between regional airlines and dominant major, and abuse in marketing.

We applaud Senators McCain, Danforth and Bond for introducing of the Airline Competition Enhancement Act of 1989 (S.1741) because it has taken the correct approach to addressing major problems in the airline industry. It seeks to eliminate anticompetitive practices and foster greater competition which will lower air fares. At the same time, the bill does not seek to alter the efficient form of organization that has emerged in the industry.

In order to assist Congress in addressing these problems, our testimony today seeks to cut through the smoke and rhetoric of airline deregulation. The defenders of anticompetitive industry practices will try to divert your attention by pointing out only the good effects of deregulation and downplaying the bad. They will insist that it is impossible to separate the wheat from the chaff, but that is not the case at all. Once you have a realistic picture of what deregulation has done, you will easily understand that the good aspects can be preserved and the bad eliminated in a broadly procompetitive approach to industry reform.

While we think that there is more that can be done and many details to be worked out, S.1741 would effectively begin separating the wheat from the chaff. S.1741 is also the philosophy that has dominated the consumers' view of airline deregulation. You will recall that consumer advocates led the charge for airline deregulation because they firmly believed, and still do, that competition is the consumer's best friend. Unfortunately, a decade of "do-nothingism" by federal antitrust and consumer protection agencies has denied us the benefits of competition.

We are not asking for a return to regulation and this bill does not propose it, but we demand real competition and this bill is a step in the right direction. If the industry structure cannot support competition, then regulation would be necessary, but in the past decade competition has barely had a chance. After the early days of deregulation, the industry's tendency to oligopoly has been allowed to run rampant by lax oversight.

For the purposes of this testimony we will focus on the issues of utilization of the air travel system, ticket prices and concentration. We have other concerns, such as how consumers are treated in the event of airline bankruptcies and the abandonment of rural America, which we believe Congress should also address, but today's hearing and this bill focuses attention on concentration and vertical integration and their negative effects on consumers.

PUBLIC OPINION ABOUT AIRLINE DEREGULATION

Let me begin by pointing out that our disappointment with airline deregulation is broadly shared by the public. At the outset, airline deregulation enjoyed the greatest support among the American people of any of the numerous regulatory reforms introduced in the late 1970s and early 1980s. Airline deregulation has also suffered the worst decline in support of any reform effort.

In the early 1980s, when competition was vigorous, a clear majority of the American people felt that deregulation was in the public interest, particularly with respect to fares. Over 60 percent supporting deregulation.[1] In the 1984/85 period, just at the point that competition in the industry began to break down, public opinion polls still found majority support for deregulation. Fifty-three percent of respondents still believed that airlines should be allowed to set fares on their own, compared to 35 percent that said they should not.[2] Fifty-six percent felt airline deregulation was in the best interest of the country and consumers, while only 24 percent believed it was not.[3]

By 1987, however, after a series of disastrous mergers that sharply increased market power in the industry and rendered a number of major airports captive to the largest air carriers, public support for airline deregulation eroded dramatically. Consumers were much more evenly split in their opinion of deregulation -- 47 percent believing it was in the best interest of the nation, 35 percent believing it was not.[4] Opinions on airline pricing freedom had reversed even more sharply. Those believing that airlines should get permission to change fares outnumbered those who did not by 49 to 43 percent.[5]

The public certainly perceives a problem, yet the industry and some analysts insist there is none. Has the public been misled by disgruntled politicians, as a member of the Federal Trade Commission recently suggested,[6] or is there an underlying experiential reality that shapes these opinions?

We believe that the latter is clearly the case. Deregulation has not done the good that has been claimed for it and it has imposed a heavy price on consumers and that is the origin of their disgruntlement with deregulation.

---

[1] Roper, May 1981. For a general and more extensive discussion about public opinion toward deregulation see, Consumer Federation of America, Public Opinion About Deregulation, May 1988.

[2] Roper, 1984.

[3] Cambridge Reports, second quarter, 1985.

[4] Cambridge Reports, second quarter, 1987.

[5] Roper, July 1987.

[6] Comments of FTC Chairman Daniel Oliver, quoted in "FTC Says Deregulation Improved Airline Safety, Cut Costs", Washington Post, January 12, 1988.

GROWTH IN THE SYSTEM

One of the most frequently claimed benefits of deregulation is a huge increase in the number of passengers on airplanes and the number of miles flown with a resulting "democratization" of air travel.[1] There is virtually no truth to the former two claims and very little truth to the latter.

When growth in ridership is analyzed, one must not give only post-deregulation trends which create an overly positive picture of deregulation. One must consider comparisons before and after deregulation to understand what effect it has had. It is true, for example, that the number of passengers and passenger miles have been growing since deregulation. It is important to note, however, that these two indicators of industry performance were growing just as quickly, or even more quickly, prior to deregulation.

Exhibits 1, 2 and 3 show three measures of growth in the system -- enplanements and passenger miles in absolute terms and also measured relative to population and income. No matter how which date one chooses for deregulation (1978 when the law was passed or 1980 when the transition was complete) there is very little difference between the pre and post deregulation periods.

Using 1978 as the onset of deregulation, we would conclude that growth was stronger prior to deregulation on all three measures (see Exhibit 4). Using 1980, we would conclude that growth was slightly stronger after deregulation. Deregulation certainly does not mark a major change in the historic pattern of industry development.

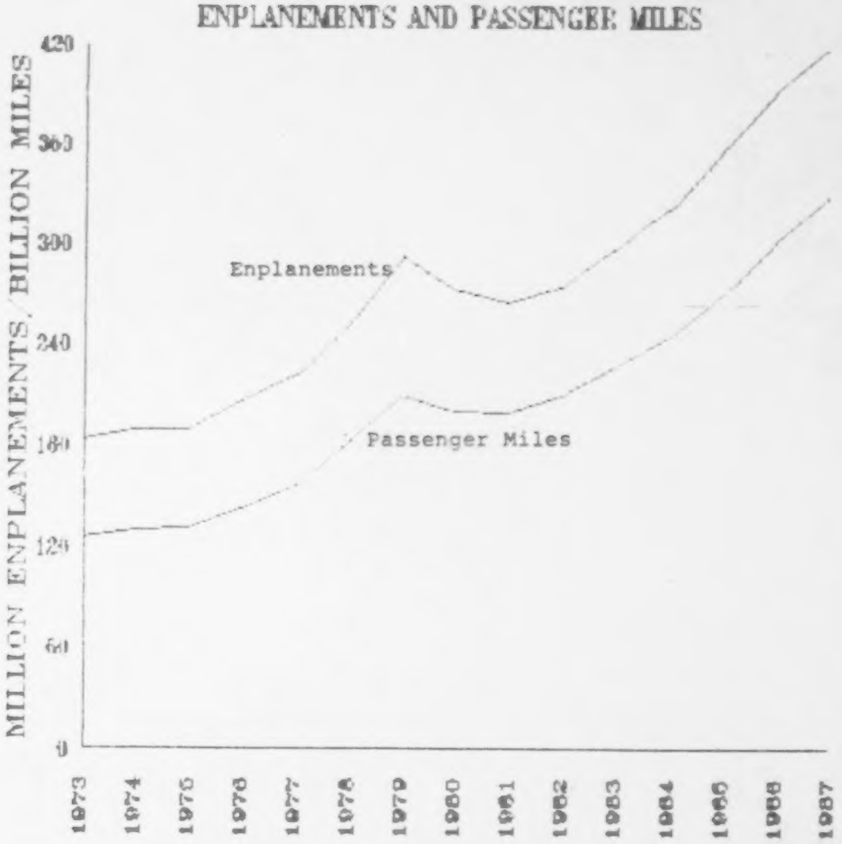
Population and income growth are two key factors that create growth in air travel and are independent of deregulation. Honest analysts know this and should always control for at least these two factors when making claims for deregulation. One econometric analysis which controlled for these and several other factors found that deregulation accounted for only about one-sixth of the increase in passenger miles after 1978, which is the most favorable of the measures included in Exhibit 4.[2]

---

[1] J. D. Ogur, C. L. Wagner, M. G. Vita, The Deregulated Airline Industry: A Review of the Evidence (Bureau of Economics, Federal Trade Commission, January 1988, hereafter refered to as FTC), p. 8. See also G. Easterbrook, "The Sky Isn't Falling," The New Republic, November, 1987, p. 18.

[2] R. B. Mckenzie and W. F. Shughart, II, Deregulation's Impact on Air Safety: Separating Fact from Fiction (St. Louis: Center for the Study of American Business, September 1987).

EXHIBIT 1

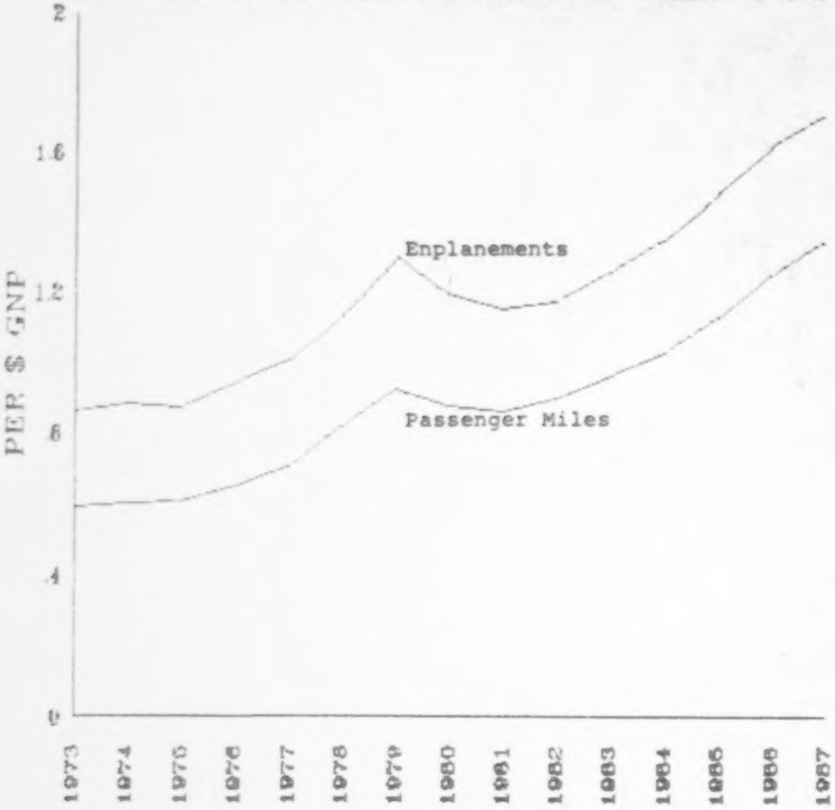


SOURCES: Airline data - U.S. Department of Transportation, FAA Statistical Handbook of Aviation, various issues.

Income and population - Economic Report of the President, February 1989, pp. 310, 343.

EXHIBIT 2

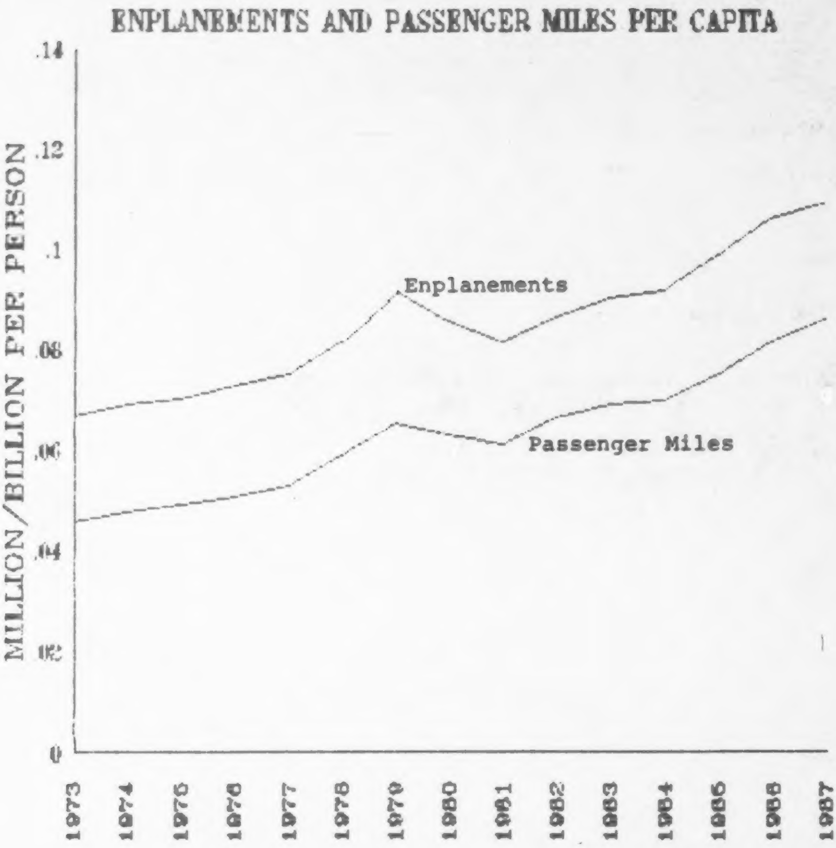
ENPLANEMENTS AND PASSENGER MILES PER DOLLAR OF GNP



SOURCES: Airline data - U.S. Department of Transportation, FAA Statistical Handbook of Aviation, various issues.

Income and population - Economic Report of the President, February 1989, pp. 310, 343.

EXHIBIT 3



ENPLANEMENTS AND PASSENGER MILES PER CAPITA

SOURCES: Airline data - U.S. Department of Transportation, FAA Statistical Handbook of Aviation, various issues.

Income and population - Economic Report of the President, February 1989, pp. 310, 343.

EXHIBIT 4

ANNUAL RATES OF GROWTH IN AIR TRAVEL BEFORE AND AFTER DEREGULATION (In Percent)

	ABSOLUTE		PER CAPITA		PER $ OF GNP	
	ENP.	MILES	ENP.	MILES	ENP.	MILES
1973 TO 1978	6.8	7.7	4.1	5.1	5.7	6.6
1978 TO 1987	5.7	6.7	3.3	4.3	4.6	5.7
1973 TO 1980	5.9	6.9	3.6	4.6	4.8	5.8
1980 TO 1987	6.2	7.3	3.5	4.6	5.2	6.2

SOURCES: Airline data - U.S. Department of Transportation, *FAA Statistical Handbook of Aviation*, various issues.

Income and population - *Economic Report of the President*, February 1989, pp. 310, 343.

DEMOCRATIZATION

Reflecting this basic continuity in growth patterns before and after deregulation, we would not expect to observe any dramatic democratization of airline ridership. Unfortunately, completely consistent data are not available from the 1970s to compare to that of the 1980s. However, the trend in the 1980s itself does not support the democratization claim.

Data from the Consumer Expenditure Survey conducted by the Bureau of Labor Statistics does allow a number of comparisons to be made (see Exhibit 5). This survey would include non-business trips, since it focuses on household expenditures. It is the most comprehensive charting of household expenditures conducted by the government.

Between 1980/81 and 1985, the percentage of urban households reporting an expenditure on an air fare increased in all income groups. Increases were greatest for the lower middle fifth and upper middle fifth of the income distribution. For this early period, only data on urban households is available.

In the 1984 to 1987 period the data for all households shows a different pattern. The percentage of lower income households reporting an expenditure for an air fare declined. For the other income groups increases were reported, but of a much smaller magnitude than in the early 1980s.

In fact, if one looks at the percentage of households reporting these expenditure across all income groups, we find no "democratization" whatsoever. If we look at the breakdown of households across income groups that reported expenditures on air fares, we find that urban, low, lower middle and middle income households accounted for virtually the same percentage of all urban households reporting air fare expenditures in 1985 as in 1980/81. The share of these three groups reporting airline expenditures in the total national sample declined between 1984 and 1987.

Thus, there has been a general increase in ridership, which was primarily due to a general increase in income, but the only disproportionate impact seems to have been to enable upper middle income households to take more trips. On a relative basis, there has been little democratization.

AVERAGE AIR FARES

One of the key elements presumed to underlie any expansion of ridership is a reduction in ticket prices. Having observed that there was little change in passenger growth from historical trends, we would expect to find little change in fares from historical trends.

EXHIBIT 5

HOUSEHOLD EXPENDITURES FOR AIRLINE TICKETS

	POPULATION SEGMENTS				
	LOW	LOWER MIDDLE	MIDDLE	UPPER MIDDLE	UPPER
	BOTTOM FIFTH	2ND FIFTH	3RD FIFTH	4TH FIFTH	TOP FIFTH
	PERCENT OF GROUP REPORTING AN EXPENDITURE				
URBAN					
1980/81	3.97	5.07	6.6	6.52	14.67
1985	5.02	6.69	8.46	9.68	17.52
ALL					
1984	4.49	4.67	6.64	7.74	15.28
1987	3.86	5.31	7.13	9.56	16.98
	EACH GROUP AS A PERCENT OF TOTAL REPORTING				
URBAN					
1980/81	10.8	13.8	17.9	17.7	39.8
1985	10.6	14.1	17.9	20.4	37
ALL					
1984	11.6	12	17.1	19.9	39.4
1987	9	12.4	16.6	22.3	39.6

SOURCE: U.S. Department of Commerce, Bureau of Labor Statistics, _Consumer Expenditure Survey_, various issues.

Once again, it is crucial to keep relative trends in perspective. Consider the following sentence, which lies at the core of a recent FTC analysis of airline fares.

> Inflation-adjusted fares have fallen an average of six percent, notwithstanding a 45 percent increase in jet fuel costs that occurred from 1979 to 1985.[1]

The sentence conveys a fundamentally incorrect perception because it compares real changes in air fares to nominal changes in fuel prices. The correct statement requires either both real or nominal changes. The correct statement would be

> Inflation-adjusted fares have fallen an average of six percent, notwithstanding a 2 percent decrease in jet fuel costs that occurred from 1979 to 1985.
>
> or
>
> Fares increased 41 percent (in current dollars), notwithstanding a 45 percent increase in jet fuel cost that occurred from 1979 to 1985.

Either way, the impression is dramatically different when the basis for the comparison is handled properly. Moreover, choosing 1979 is odd, since it is not a clear demarcation point for regulatory policy. It does create the maximum confusion between fuel prices and deregulatory impacts.

In fact, analysis of airline fares is extremely complex for a number of reasons.

One fundamental problem is highlighted by the mistake made by the FTC. There are a number of factors that strongly affect fares and these did not sit still over the regulation-deregulation period. Some had little or nothing to do with deregulation and can distort the evaluation of deregulation. Exhibit 6 shows the pattern of fuel price changes and ticket yields between 1978 and 1987. The two move together closely, except in recent years when the decline in fuel prices appear much greater than the decline in ticket yields.

Second, even if one controls for all other factors and analyzes fares on a disaggregated basis or makes assumptions to create a weighted average, it is difficult to establish exactly what fares would have done under regulation. The Civil Aeronautics Board (CAB), which regulated price and schedules, had begun to take a more flexible approach to setting fares.

---

[1] FTC, p. 6.

For example, the CAB had changed its assumption about load factors, which led to a reduction in rates. Since, as we have seen, traffic densities would have increased without deregulation because of income and population growth, it is likely that the CAB would have been compelled to change its assumptions about load factors again lowering prices further. Similarly, the CAB had begun to allow discounting of tickets. There is no reason to assume that the CAB would not have pursued a more flexible approach to pricing as the volume of traffic on the system built up -- perhaps allowing peak period pricing.

The bottom line on fares is that there is probably little difference between what they would have been under the more flexible approach to regulation which was emerging in the mid-1970s, but they are not nearly as low as they could be with vigorous competition.

MARKET POWER AND PRICING PATTERNS

Air fares are also considerably more complex. Generally, coach fares have increased but discount fares have decreased. The magnitude of these changes varies from market to market and it is extremely difficult to know how much consumers are actually paying for their tickets, since one does not know whether they get a discount (the majority does) and how much they actually pay. Moreover, the magnitude of discounts is extremely fluid, changing as the nature and extent of competition changes. With the decline in competition in recent years, the availability of these discounts is also diminishing.

The fact that price structures have changed differently in different types of markets and for different types of tickets raises the question of the exercise of market power and price discrimination.

> Have airlines gained sufficient power through concentration and other organizational changes to set prices in an oligopolistic or monopolistic fashion?

This bill focuses attention on market concentration at hubs as one of the key problems in the industry and it is right on target. Concentrated hubs hurt consumers because they are formidable barriers to entry behind which airlines raise prices and reduce consumer welfare.

Even before the more recent mergers, with their resulting increases in concentration and market power, studies showed that market shares and concentration were an important determinant of price.

Virtually every analysis of airline fares has found that the number of competitors and their market share has a statistically significant impact on price.[1] The greater the concentration, the higher the price. Econometric studies based on data from 1981/1983 found that prices in monopolized markets were approximately 25 percent higher than in highly competitive markets.

> When Herfindahl is entered as an exogenous variable, the coefficient is 0.086 and is highly significant. This implies that the fare in a market with two equal sized competitors (i.e. a Herfindahl Index of 0.5) was 6 percent lower than in a monopoly market. A highly competitive market with four equal sized airlines (i.e. a Herfindahl of 0.25) is estimated to have an average fare that is about 11 percent below the monopoly fare.[2]

Studies based on data for 1986 indicate that the anticompetitive price may be even higher. For example, one study based on second quarter 1986 data found "that a 10% increase in the average endpoint enplanement market share for an itinerary would lead to a 4.2% increase in average fare."[3]

---

[1] E. E. Bailey, D. R. Graham and D. P. Kaplan, *Deregulating the Airlines* (Cambridge: MIT Press, 1985) Chapter 9; D. R. Graham, D. P. Kaplan, and D. S. Sibley, "Efficiency and Competition in the Airline Industry," *Bell Journal of Economics* 14, 1983; S. Morrison and C. Winston, *The Economic Effects of Airline Deregulation* (Washington, D.C.: Brookings Institute, 1986), Chapter 6; G. Call and T. E. Keeler, "Airline Deregulation, Fares and Market Behavior: Some Empirical Analysis," in A. F. Daughety (Ed.), *Analytical Studies in Transport Economics* (Cambridge: Cambridge University Press, 1985); L. L. Selwyn, "Competition in the U.S. Telecommunications Industry," *U.S. House of Representative, Committee on Energy and Commerce, Subcommittee on Telecommunications and Finance*, July 15, 1987.

[2] Bailey, Graham and Kaplan, op. cit., p. 165.

[3] S. Borenstein, *Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry* (University of Michigan: Institute of Public Policy Studies, March 1988), p. 22.

The above two studies use cross-sectional data, which compare fares and market shares on a large number of routes at one point in time, controlling for a host of other factors. The data in the second study is contemporaneous with the merger at St. Louis. The econometric data are consistent with the impact of the merger on St. Louis (see Exhibit 7).

The TWA-Ozark merger raised TWA's market share by approximately 26 percent and raised the Herfindahl from approximately 39 to approximately 68.[1] The findings of a General Accounting Office before and after study of TWA's pricing practices in St. Louis are consistent with the cross-sectional results.

The early Herfindahl-based estimate predicts a concentration-caused fare increase of 5 percent. The later market share study predicts a concentration-caused fare increase of 10 percent. Measured in real terms, the increase in the first quarter after the merger was 11 percent. Fares were 8 percent in the next two quarters compared to the year before the merger. TWA fares increased 19 percent more in the first quarter after the merger than the increases imposed by other airlines at St. Louis. In the next two quarters TWA fares went up 6 percent more than fares on other airlines for St. Louis flights.

There is no doubt that concentration at hubs costs consumers money.

PRICE DISCRIMINATION

The exercise of market power has also become intertwined with price discrimination. Exhibit 8 shows pricing patterns in market with various levels of competition. The availability of discounts is directly related to the number of competitors in a market. In 1983, only one quarter of monopolized markets had discounts available. In contrast over three quarters of market with four or more competitors had discounts available. Between 1976 and 1983 prices had increased much more sharply markets served by only one or two carriers than in markets served by more carriers, especially those with five or more.

Exhibit 9 shows price comparisons between regulated and deregulated fares for 1977 and 1983 for coach and discount tickets. Coach fares are associated with non-discretionary (low elasticity of demand) travel, while discount fares are associated

---

[1] U.S. General Accounting Office, Airline Competition: Fare and Service Changes in St. Louis since the TWA-Ozark Merger, September 1988, p. 8.

EXHIBIT 7

ESTIMATES OF THE IMPACT OF THE TWA-OZARK MERGER ON ST. LOUIS, TWA PRICES

	PERCENT INCREASE
ESTIMATE BASED ON HERFINDAHL INCREASE[1]	5
ESTIMATE BASED ON MARKET SHARE INCREASE[2]	10
OBSERVED CHANGE ABOVE CPI[3]	
First Quarter 1986/1987	11
Second Quarter 1986/1987	8
Third Quarter 1986/1987	8
OBSERVED CHANGE ABOVE OTHER CARRIERS AT ST. LOUIS	
First Quarter 1986/1987	19
Second Quarter 1986/1987	6
Third Quarter 1986/1987	6

---

1. E. E. Bailey, D. R. Graham and D. P. Kaplan, Deregulating the Airlines (Cambridge: MIT Press, 1985), Chapter 9.

2. S., Borenstein, Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry (University of Michigan: Institute of Public Policy Studies, March 1988), p. 22.

3. U.S. General Accounting Office, Airline Competition: Fare and Service Changes in St. Louis since the TWA-Ozark Merger, September 1988, pp. 17, 19.

EXHIBIT 8

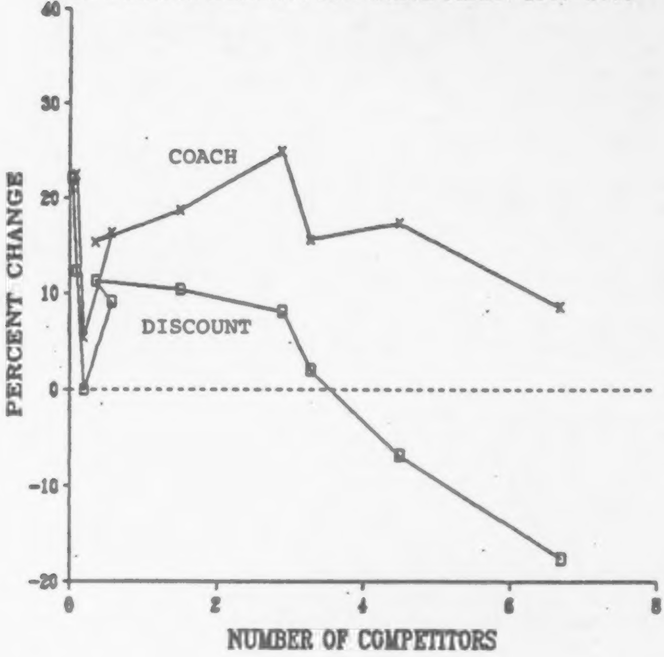
PRICING PATTERNS IN COMPETITIVE AND NON-COMPETITIVE AIRLINE MARKETS

NUMBER OF CARRIERS IN MARKET	PERCENT OF MARKETS WITH DISCOUNTS IN 1983	PERCENT INCREASE IN FARES 1976-1983
ONE	26	44
TWO	58	47
THREE	55	33
FOUR	80	31
FIVE OR MORE	77	3

SOURCE: T.G. Moore, "U.S. Airline Deregulation: Its Effect on Passengers, Capital, and Labor," Journal of Law and Economics. April, 1986.

EXHIBIT 9

CHANGES IN DISCOUNT AND COACH FARES: 1977-1983



SOURCE: S. Morrison and C. Winston, The Economic Effects of Airline Deregulation (Washington, D.C.: Brookings, 1986), p. 23.

with discretionary (high elasticity of demand) travel. All fares are higher under deregulation, except for discount fares at large hubs.[1] Fare increases are larger on less competitive routes. The econometric analyses cited above indicate that this price discrimination obtains when other factors which affect costs (and presumably prices) are controlled. Fares are higher in lower density markets and non-tourist markets.

Exhibit 10 shows more recent data on the lowest unrestricted fare charged on a per mile basis on competitive and non-competitive routes. It suggests larger effects of market power in more recent years. This too is corroborated by the econometric evidence cited above.

CONCENTRATION AND PUBLIC POLICY

The extremely high levels of concentration on most routes and the clear demonstration of the correlation between concentration and price raises a fundamental policy issue. On a route-by-route basis, the number of competitors is extremely small (see Exhibit 11). Low density routes average slightly more than one airline per route. High density routes average only three airlines per route. These data are from 1983, so matters have certainly gotten worse with the major mergers of 1986-87.

These levels of concentration should trigger extreme concern. Over 95 percent of all city pairs are highly concentrated by the antitrust standard of the Department of Justice. Over half of all passengers leave from airports where the dominant firm has a market share larger than the Department of Justice's leading firm proviso (35 percent).[2]

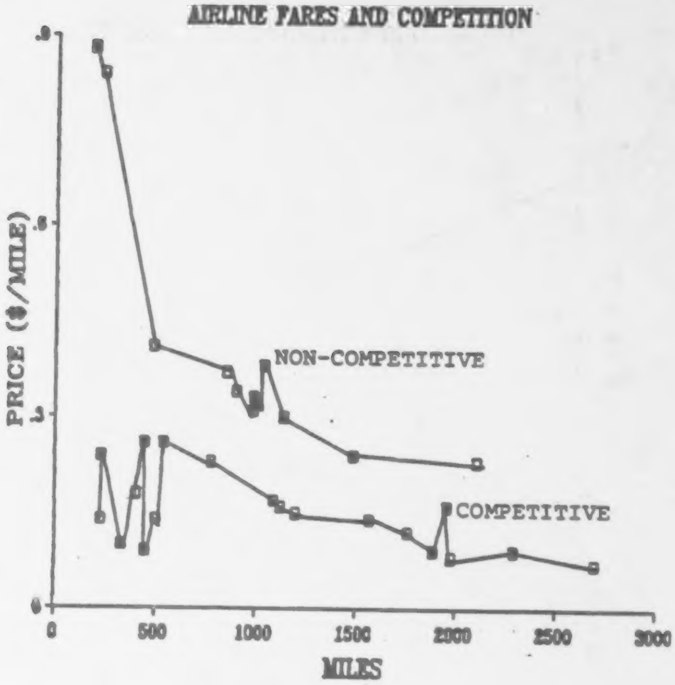
---

1. These results are based on Winston and Morrison, op. cit. They conclude that not withstanding the fare figures, welfare analysis shows that consumers are better off in the aggregate. We believe that they have overestimated the gains for a variety of reasons which are described in Appendix A.

2. Department of Justice, Merger Guidelines (Washington, D.C., 1984); Analyses that raise concerns about hub concentration can be found in L. T. Phillips, "Air Carrier Activity At Major Hub Airports and Changing Interline Practices in the United States Airline Industry," Transportation Research 23A, 1987, "Structural Change in the Airline Industry: Carrier Concentration at Large Hub Airports and Its Implications for Competitive Behavior," Transportation Journal, Summer 1985; R. G. Higgins, "The Impact of Hub and Spoke Network Centralization and Route Monopoly on Domestic Airline Profitability," Transportation Journal, Summer 1985.

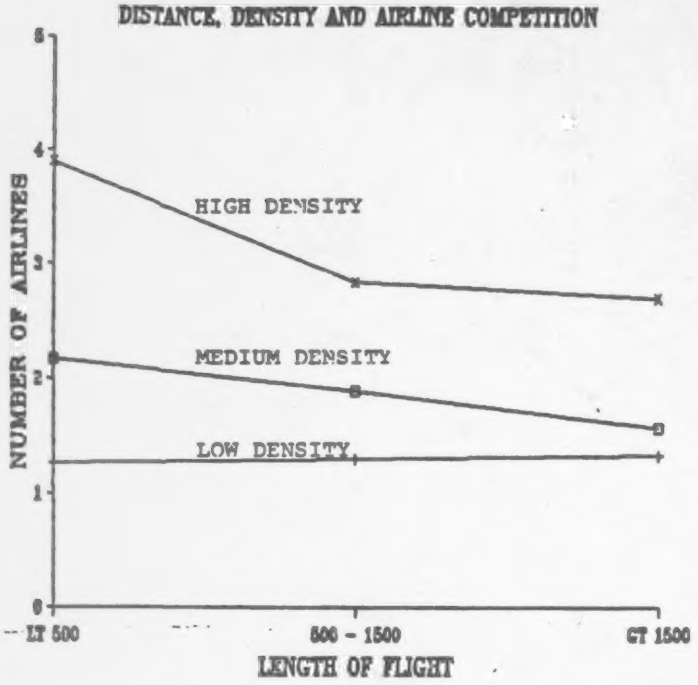
EXHIBIT 10

AIRLINE FARES AND COMPETITION



SOURCE: L. L. Selwyn, "Competition in the U.S. Telecommunications Industry," U.S. House of Representative. Committee on Energy and Commerce. Subcommittee on Telecommunications and Finance, July 15, 1987.

EXHIBIT 11



SOURCE: S. Morrison and C. Winston, The Economic Effects of Airline Deregulation (Washington, D.C.: Brookings, 1986), p. 23.

Many of the advocates of deregulation cite the theory of contestability as a palliative for this extreme degree of concentration. This theory stated that actual competition was not necessary to achieve a quasi competitive outcome. The mere threat that a competitor could enter the market was said to be sufficient to discipline the behavior of firms in the market, if entry and exit were sufficiently frictionless. The airline industry was offered as the example, par excellence, of a contestable market.[1]

Every empirical test of the contestability theory in the airline industry has found that it is inapplicable (as have tests for virtually every other industry).[2] In one of the most sophisticated tests, the conclusion is that one competitor in the hand is worth at least three in the bush, and if the competitor in hand is a super major, he is worth six potential competitors in the bush.[1]

---

[1] E. E. Bailey, "Contestability and the Design of Regulatory and Antitrust Policy," American Economic Review, May 1981.

[2] Many economists criticized the theory loudly because of the unrealistic assumptions on which it rested. Immediate reactions came from M. Schwartz and R. J. Reynolds, "Contestable Markets: An Uprising in the Theory of Industrial Organization: Comment," American Economic Review 73, 1983; On The Limited Relevance of Contestability Theory (U.S. Department of Justice, Antitrust Division, Economic Policy Office, Discussion Paper No. EPO 84-10, 1984); M. L. Weitzman, "Contestable Markets: An Uprising in the Theory of Industry Structure: Comment," American Economic Review, 73, 1983.

Extensive critiques can be found in M. A. Spence, "Contestable Markets and the Theory of Industry Structure: A Review Article," Journal of Economic Literature, 21, 1983; W. G. Shepherd, "Contestability v. Competition," American Economic Review, 74, 1984 and "Illogic and Unreality: The Odd Case of Ultra-Free Entry and Inert Markets," in R. E. Grieson (Ed.) Antitrust and Regulation (Lexington: Lexington Books, 1986); and W. Brock, "Contestable Markets and the Theory of of Industry Structure: A Review Article," Journal of Political Economy, 91, 1983.

Above all, criticism of the theory has focused on the extreme assumptions about ease of entry and exit and an absence of sunk costs. This is exactly the problem that arises with the creation of fortress hubs.

Actual competition is what disciplines behavior in the airline industry (and virtually every other industry). Facing high levels of concentration and no hope that contestability will adequately discipline market power, intervention in the market place to prevent the abuse of market power would appear to be necessary to protect the public interest.

POLICY PRESCRIPTIONS

The Airline Competition Enhancement Act of 1989 has identified the key impediments to competition.

The computerized reservation system must be reformed. The dominant airlines control access to the stream of commerce through their control and manipulation of computerized reservation systems. Computerization is obviously efficient, but it need not be anticompetitive.

The bill proposes to separate the ownership interest of the computer system from the ownership interest of the airlines. This is the only way to ensure fair operation of the reservation system.

Fortress hubs must not be allowed to form the core of monopoly networks. The dominant airlines have constructed impenetrable hubs in major airports which freeze out competition and balkanize the national market. Concentrating the flow of traffic through hubs has proven to be efficient, but it is not clear that this concentration of traffic can only be achieved through a concentration of ownership or control of airport facilities.

The bill proposes to give airports greater leverage in achieving the construction of competing facilities. We would like to see more authority to ensure fair access to bottleneck facilities.

Affiliation arrangements with regional airlines must not be allowed to squelched competition. The dominant airlines eliminate the chance of regionals growing into serious competition by coordinating with them.

The bill proposed to prohibit code sharing. This is the leading edge of the anticompetitive impact of affiliations, since sharing identities fools the public into believing there are no alternatives for the local leg of long distance flights. We are concerned about other potentially anticompetitive impacts of these affiliations.

---

[1] Morrison and Winston, op. cit., Chapter 6. Other empirical refutations of the theory can be found in Call and Keeler, op. cit., and Moore, op. cit.

Finally, the bill proposes to give the FTC authority to oversee the industry. This will remove consumer protection for an agency whose primary purpose is to promote the industry to one whose primary purpose is to protect consumers and defend competition.[1] While we have not always been pleased with the approach taken by the FTC, it is obviously the correct place for consumer protection authority to reside.

---

[1] Although we have focused on price in this analysis, the conentration and integration in the industry certainly breeds anticonsumer impacts along non-price dimensions. Advertising scehdules that cannot be met is misleading, as is listing regional airline flights under the same codes as majors. The terms and conditions of seats available, rights and obligations of frequently flier programs, all are matters worthy of close oversight by an agency specializing in abusive practices at the point of sale.

APPENDIX A: PROBLEMS IN COUNTERFACTUAL ESTIMATION OF CONSUMER GAINS FROM DEREGULATION

A variety of counterfactual analyses of airline deregulation have been conducted. The most sophisticated is Morrison and Winston, op. cit.

They take a set of facts -- the performance of the industry after deregulation -- and compare them to a set of counterfacts -- a hypothetical estimation of how the industry would have performed if deregulation had not taken place.

While this type of analysis is common, it requires a host of problematic assumptions. Many of these problems have been suggested by our critique of the FTC's presentation of the basic data which underlies such analyses.

First, one must try to control the impact of other factors, such as economic growth and fuel prices, on the performance of the industry so that the effects of deregulation can be isolated. The problem of analyzing airline deregulation is especially complex because of a number of unique factors -- the PATCO strike, the worst recession since the great depression for an industry that is highly sensitive to the level of economic activity, a wave of mergers, etc.

Second, a particularly important aspect of this analysis and one which is very difficult in the airline industry is the construction of the counterfact. It is easy to set up straw men whose demise proves little.

In the case of airline deregulation, the counterfacts are suspect. One approach is to carry regulatory formulas forward without modification. Yet, as already noted, the CAB had shown a willingness to alter both of these formulas and broader policies in response to changes in the industry. Therefore, the baseline projection underestimates the economic regime that regulation would have pursued.

Another approach to the counterfactual analysis projects deregulation from the present into the past. Under this approach, it is still necessary to make projections about what rates would have been, but the weight falls not on regulatory formulas but modeling deregulated behavior.

All economists argued that regulation, which limited the ability of airlines to compete on price and flight schedules, caused them to compete on quality -- to gold plate their services in order to attract passengers. Deregulation inevitably meant a decline of service quality as price competition squeezed out quality. Most studies have made no effort to actually measure the decline of quality.

Some of the costs of declining quality are small or intangible -- smaller planes on many routes, no meals, and reduction in other services. Others are neither small nor intangible.

The studies also tend to compare only flights between cities which were served both before and after deregulation. Yet, one of the inevitable effects of deregulation was the loss of service in some communities. To date, as noted above, it appears that many more cities have lost service than gained it. This is another unmeasured cost.

Most studies rely on flight schedules, not actual arrival times. Therefore, flight delays or cancellations and passenger bumping do not enter into the analysis. Nor do these studies take into account time-consuming hassles with lost or misplaced luggage.

Much of the recent consumer uprising relates to the very bothersome way that airlines eat up consumer time when they cannot meet their schedules. Time is the essence of the benefit that most studies find for consumers, but real time never enters into the studies. In many respects these analyses do not model the airline industry as it actually functions in the present, instead they model the industry as it would function if it could meet its schedules.

Most of the complex studies also rely on data from 1983 or earlier. Those were the early days of deregulation. The price cutting airlines were still in business and the wave of mergers had not swept through the industry. In some respects the airline industry of 1989 bears no resemblance to the airline industry of 1981-1983. Most analysts believe that the halcyon days of competition which typified that early period are never to return. If anything, they expect the industry to become more and more concentrated.

In short, rather than comparing a fact to a counter fact, these analyses degenerate into a comparison of two counter facts. The compare how the airline industry might have looked under regulation to how it would look under deregulation, if it actually met its schedules and one could measure the intangibles. The resulting picture is fundamentally biased because the regulators are painted in their worst light, while the industry is depicted in its best.

These observations are not intended as a rejection of complex counterfactual policy research. Problems of measuring social and economic phenomena on a comprehensive and timely basis are the bane of policy analysis.

It is clear in this case that the counterfactual is too bullish on deregulation. Moreover, the important point to recognize is that these complex studies do not demonstrate that public perceptions of problems in the industry at present are ill-founded. There is more than enough of a gap between the complex analyses (that are measuring, poorly, phenomena that are four to six years old) and present reality to explain, logically and rationally, the divergence of perspectives between the public and academicians.

Senator Ford. Doctor, you heard Senator Metzenbaum earlier refer to his piece of legislation that he and Senator Byrd, are introducing legislation to establish an independent board, and that independent board would regulate fares and routes.

Given your comments today about airline deregulation, how would you view such legislation?

Dr. Cooper. As I said, we would like to see vigorous efforts to promote competition at this stage, rather than re-impose regulation of fares and routes. And if you look at what this bill does, it does not in fact tell airlines where to go.

In a certain sense it tells them some things they cannot do at some places.

Senator Ford. Let us stay with Senator Metzenbaum's bill, though. You got off onto this bill. I want to get you back to Senator Metzenbaum's bill, which wants the independent board to regulate fares and to regulate routes.

Now, are you for or against that sort of thing?

Dr. Cooper. I made it clear, we would like to see policies to promote competition rather than reregulate the industry.

Senator Ford. Well, so then you are against the commission or against the Metzenbaum bill?

Dr. Cooper. I am against that title of the bill. The other two titles in terms of consumer rights we think could easily be incorporated into the context of reinvigorated consumer protection.

Senator Ford. Now, you are very strong for the FTC. We have had a lot of problems with the FTC. The Chamber of Commerce does not like the FTC very well. They are beginning to worry about FTC, though, they say, that there are too many lawyers running around looking for a job and they are finally getting some good ones down there and they are beginning to worry about 900 to 1,000 lawyers.

I do not find that they are out there doing all this good work that is being promoted by those who are in favor of this piece of legislation.

Why is the FTC so good?

Dr. Cooper. Well, as I said in my testimony, we have not always been pleased with the performance of the FTC, but that is the right place for the authority to execute consumer protection.

Senator Ford. If you have the authority and you are not pleased with its performance, what good is it?

Dr. Cooper. Well, the vigor with which any administrative agency will pursue its legal authorities is a function of the Administration in the White House. We have had a change.

Senator Ford. We have had a continuation. We are having a continuation of the last 8 years.

Dr. Cooper. My political affiliation would share with you the hope that we would get you more of a change at some time in the future. But I believe we have a new set.

Senator Ford. I can live with some of the fellows on that side of the aisle now. But I think that what we are doing here—you just said the FAA was organized for one purpose and that was to protect and promote the airline industry.

I disagree with you a little bit. I think it is out there trying to make it safe for the consumers to fly on, with their inspections, with the controllers, with all the problems that they have to deal with today. It seems like to me they have more—they may be protecting the passengers there a little bit more than they are protecting the airlines themselves.

Dr. COOPER. Well, the agency I was referring to was the Department of Transportation, which has any residual economic regulatory authority. And that is the Department, as you heard, that has certainly approved every merger and we feel has not acted very vigorously in either pro-competitive or pro-consumer policy implementation.

We would like to see the FAA more active in its safety.

Senator FORD. Well, if we can make that independent you might be able to get it. So I want you on my side a little bit here.

You stated that the airline computer reservation systems need not be anti-competitive. If CRS divestiture is viewed by the committee to be too extreme, what other suggestions do you have for improving upon the current CRS situation?

Dr. COOPER. Well, it is possible to go in and reform a discreet list of practices that you have heard. I mean, if you say we cannot impose divestiture, then you have heard identified a series of discreet practices. It is a fairly long list, but there are identifiable practices that can be reformed.

I guess the fundamental question you will encounter is how you will have on a continuous basis the policing of the system. That is, if we agree that we need to outlaw certain types of contracts, certain types of incentives, to assure fair access to certain types of reports and information, you will then create the administrative problem of ensuring that those stipulations are met.

Whether you will end up with an independent agency to oversee the management of CRS or some binding private sector negotiation-arbitration process—I mean, there are other ways to do it, all of which probably fall short of the clean break in terms of the potential anti-competitive effect that would be eliminated with divestiture.

Senator FORD. One of the provisions of S. 1741 grants discretionary authority for the imposition of passenger facility charges at concentrated hub airports. As a representative of the consumers, how do you think air travelers will respond to another aviation tax, particularly when we have a $7 billion surplus on the tax that we have been collecting now?

Dr. COOPER. We certainly lament the surplus which has not been spent in an effective fashion and should be spent to improve the plight of the traveling public.

This grant of authority is very specific and very much targeted at a pro-consumer effect, enhancing competition. So that if and when you find airlines and airports so concentrated, so intransigent, that the authority deems it necessary to go ahead and issue those or exercise those powers, argues that before the Secretary, I think the consuming public would be served because of this very specific and concrete nature of the authority.

Senator FORD. They are just that four airports, are they not?

Dr. COOPER. No, no. This authority would apply to all airports deemed concentrated.

Senator FORD. We only have four now.

Dr. **Cooper**. No, no, those are slot-constrained airports. My reading—and my reading could be wrong. My reading would be anything that meets those economic characteristics would be subject to the potential authority.

Senator **Ford**. Let me just say to you, I do not know whether you know anything about politics, but I understand there are at least 22 airports that would be included in this and I am already getting beat over the head by the Senators from those states that have those airports, so that it is going to be very difficult to do anything like that.

They would hate to see the consumer stuck with something else when we cannot even get a trigger tax or a trigger position to use the $7 billion. Now we are trying to find a way to get around that procedure where the money is collected from an individual that has to fly from that area.

So I am somewhat concerned and I think you will find that the political atmosphere is going to be very difficult. If we pass it, it is going to be difficult to put it on in the local level in my opinion. Senator Danforth.

Senator **Danforth**. I would like to ask you one question with five subparts, and ask you if you can just hit these in about one minute each, rather than go on at great length. Really, the one question is whether in your opinion, under the practices which have been identified by the various studies and we deal with in the legislation, whether these various practices are instances of basic market forces at work, or whether they are inherently anti-competitive:

One, CRS ownership by airlines. And I will just pause.

Dr. **Cooper**. I think that ownership practices as the system has been implemented are anti-competitive. The interesting thing is that I believe most analyses have identified that. All the analyses that the airlines seem to cite to as defending deregulation almost invariably identify CRS as an anti-competitive problem that needs to be addressed.

Senator **Danforth**. All right. Two, code-sharing.

Dr. **Cooper**. I think code-sharing clearly eliminates the possibility for regionals to become serious competitors. We also believe it misleads the public into thinking that they are getting the same thing when in point of fact they are not.

Senator **Danforth**. All right. Third, majority-in-interest clauses.

Dr. **Cooper**. It is not my particular area of expertise, but it seems to me that what majority-in-interest clauses do is take the monopoly power of the airport, which is a clearly recognized monopoly, and transfers it to an airline to give it essentially, if not absolute veto, then clearly a tremendous power of coercion over the airport. It essentially transfers that right.

Senator **Danforth**. Fourth, long-term leases.

Dr. **Cooper**. Well, long-term leases always restrict the ability of the marketplace to respond, and we hear complaints about long-term contracting in a variety of industries. So they clearly diminish market responsiveness, and it will vary depending on the nature and magnitude of the market.

Senator **Danforth**. And finally, slots.

Dr. COOPER. Well, clearly the slots are conferred rights which transfer the economic rents inherent in those rights. And we think that as long as there is going to be a constraint on capacity, those rents will exist. They ought to be captured for the public interest, not the private profit of airlines.

Senator DANFORTH. Some say that the status quo is fine, that the public is benefiting and we should all be thankful for the status quo, and that if we attempt to do anything about this there would be a great political uproar and so on.

You are here representing the Consumer Federation of America. What is your opinion of the attitude of consumers today toward the present situation in air transportation? Do they think everything is hunky-dorey and that Congress would be foolish to address the matter? Or in your opinion are people less than satisfied with the status quo?

Dr. COOPER. As I pointed out in my testimony, if you track public opinion polls about airline deregulation, it has suffered a dramatic loss in public support, to the point where that you have now certainly a plurality of people who would in fact invite the setting of fares. It is a close plurality.

But this is a deregulation, if it were an elected official there would be panic in the press corps, in the press officials, about how bad the polls were running, given where it started. So that there is strong felt concern about deregulation.

I must say, let me say one other thing about the Brookings study, which has been raised several times, because it purports to show us a tremendous benefit to consumers. At the end of my testimony I point out about a dozen reasons why that academic view of what the industry looked like in 1983 might be radically different from what the public is feeling in terms of its perception of what the industry actually does to them in 1989.

Let me give one particular example. The Brookings study estimates consumer welfare gains—and obviously I represent consumers; I cannot be against consumer welfare gains. It estimates consumer welfare gains as a comparison between what regulators would have done—and I do not think they have got a particularly good picture of what the regulators would have done—and against what airlines would do if they did meet their schedules.

Well, look at the consumer loss in those delays and cancellations. It does not take those into account. It does not measure the fundamental reality that consumers feel.

So when the polls are collapsing in support of regulation and the academics are telling you it is good for them, you have to look carefully at what they really measured and when they measured it. And I think there is strong support in the public for reform, I do not think necessarily for reregulation however.

Senator DANFORTH. Dr. Cooper, thank you very much.

Mr. Chairman, I would like to thank you for your willingness to hold this hearing at an early date after the bill was introduced, for your patience in being here and presiding over this hearing, and for your cooperation. Clearly, I would guess that there are possibly some differences of opinion between us on the merits of the legislation, but it is very characteristic of you to be willing to hold the hearings despite some possible misgivings you have.

Senator **Ford**. I just started leaning toward his bill.

Let me just wind up, Dr. Cooper. I am a small businessman. I struggled from $35 a week to where I could pay my grocery bills at the end of the month. And I find it somewhat grating on me that every answer you gave to Senator Danforth was anti-business.

You did not look at the collateral I must have in order to make an arrangement, in order to invest my company's money, my brother and my father and my son, to invest that money in order to be sure that the consummation of that contract was as good and as safe as possible.

Now, you are saying to an industry—and you find that the debt to equity by Delta is probably as good as any and probably better. Their net profit is 3.7 percent. Yet we are banging on them to get into third generation airplanes, for noise pollution.

We get into all this, but you say to them that if they stand good for $150 million at one airport that you do not want them to have anything to make that solid, to sign the contract with the approval of their board of directors and their stockholders.

Now, you can probably come back and give me a good argument. I had a lawyer one time, I turned around and asked him, I said: Which way should we go? He said: Go either way and we will make a damn good argument.

That is what I am finding here. Everybody is making damn good arguments. But somehow or another, we are getting into—I heard get off their backs and out of their pockets. I heard that from 1976 until the election of 1980.

Now we are finding, get back into their pockets and get back on their backs. Maybe what goes around comes around. Dad always said, if you miss a train and stand there with your hat and suitcase it will be back.

Dr. **Cooper**. Mr. Chairman, let me respond. One, if you are a small businessman you are not going to get into these problems. Let us be clear about that.

Senator **Ford**. Oh, you get into them on a different scale. It is just as important to me to borrow $50,000 as it is to borrow $5 million for them.

Dr. **Cooper**. But the problem we are talking about here at the center of this bill is market power by entities that have huge market shares at these fortress hubs.

Senator **Ford**. Senator Metzenbaum has stated that the worst mistake he has ever made was breaking up the Bell Company. He was for breaking them up and deregulating them and making them smaller. He sat there at the table today and said it was wrong to deregulate and break it and let everybody go on their own.

So now we are having a big turn-around. Those that advocated your position—I will guarantee you Senator Metzenbaum on your rating is probably 100 percent, and yet he said, I made one hell of a mistake.

Now, are you still with Senator Metzenbaum or he still with you? That is what I want to know.

Dr. **Cooper**. Well, the fact that we sometimes or frequently stand together does not give either of us a veto right on our positions.

Senator **Ford**. Oh, I understand that. But the attitudes are changing just a little bit, and I think we should be very careful.

Dr. **Cooper.** We both perceive a significant problem in the industry. And the question you have asked about what sort of extraction an airline should be allowed to make from an airport in order to underwrite their $150 million, it is an interesting and peculiar contract.

That is, are you telling me that they need to go to the bank with a contract that says, I cannot have competition at this airport? It seems to me that if that contract were written between various and sundry parties, if one of the parties was not a state authority, it would be readily challengeable as a violation of the antitrust laws.

That is not the only kind of guarantee people go to the bank with, to say that I cannot have competition. This is a unique case where that airport has monopoly power, and in this case it can confer it on the airline. It should not, but it can. And that is a very odd sort of way to do business.

If that is what you are saying about how small businesses work, most small businesses cannot extract anti-competitive deals from other folks as guarantees to take to the bank.

Senator **Ford.** I have seen small businesses go in, as an agent goes into business, and even in their small percentage put in Wang machines or similar computer operations in order to make them connect up. Major insurance companies with little agents down in the community, they have got a computer and they communicate with their insurance company, the policy comes right out down here.

Now, are you telling me that CRS has got to go, that one insurance company has it and another insurance company does not have it, so we have got to take that agent down the street that has it with the Travellers or the Aetna or whoever it might be and say, you cannot do that, you are too competitive because you have got the CRS or you have got a computer in your office?

Dr. **Cooper.** Well, with respect to airports, obviously, you do not have multiple offers of service. You only have one airport, so that is an inherent underlying monopoly.

Senator **Ford.** Yes, but you only designate one agent under insurance in a community.

Dr. **Cooper.** You have a free choice of agents.

Senator **Ford.** Sure, absolutely.

Dr. **Cooper.** And some of us would like to see more competition.

Senator **Ford.** Hart, Schaffner and Marx, you know, they do not sell suits at every men's store. So there is something fundamentally here to me that, even though they are big, that we are trying to say to them: Look, you have got to have Big Brother looking over your shoulder and we are going to tell you how to operate; and if you do not like it, here is the law and you can get out.

So they will sell out and be financed by foreign entities, and it just keeps coming at us.

I have just got something that bothers me considerably about what you are trying to do. The ideal is perfect, the ideal is perfect. But it is just like being a Christian; you are not perfect, but you strive to be perfect. But the ideal is perfect, but we are striving, trying to find something here. What we are doing, I think, is imposing too much on the industry that is struggling.

You know, you talk loud and I like to listen to you. Do not worry about coming back at me.

Dr. COOPER. Well, the problem with computers—we have now shifted back from airports to computer reservation systems.

Senator FORD. Well, it is all over. It is all over. All these little pieces fit together.

Dr. COOPER. And obviously there are different remedies proposed for different problems in this bill, all of which do not impose regulation, but seek to promote competition. If you walk through the logic of CRS, you have the following observations:

One, competitive disadvantage, even gained fairly in the marketplace, can be abused and Big Brother looks over people's shoulders. That is the antitrust laws and, as you pointed out, they are out there.

In this particular case it is not even clear that competitive advantage was gained in the free market. It may well have been conferred by a history of regulated routes and therefore was given, rather than won.

And obviously deregulation set up a policy that was intended to promote the public interest, and what we discover is that that right conferred, rather than won, has become an instrument for frustrating public policy.

So I understand you look at it that way. But if you look at it that way, from my perspective we had a public policy that was pro-competitive, we conferred some benefits on airlines through a prior history of regulation. They are now using that advantage which has been capitalized, if you will, in the CRS to frustrate public policy, and we think that needs to be addressed.

Senator FORD. What are you going to do about radio stations? What are you going to do? They are conferred. We still own those. They belong to the taxpayer. We are conferring the airways, both radio and TV. I do not hear you coming up here saying let us deregulate all those people.

We have got a little problem with cable, that the networks are beginning to get very, very concerned about because they are becoming bigger. ESPN now, you know, is doing lots of things, and CNN is on the local Fox or whatever.

Dr. COOPER. I think next week you will hear us say similarly pro-competitive things about the cable industry. We do believe in competition.

Senator FORD. You cannot have competition if somebody gets ahead and you knock him down. There is no incentive to get ahead. Why should I want to get ahead if about the time I get out there and I have got a good idea and it is innovative and I am beginning to make something and you say, oh, that boy is going too well, we have got to haul him in, we have got to make him equal to everybody else.

Dr. COOPER. Our public policy clearly recognizes there are fair and unfair ways to get ahead, and it regulates the unfair.

Senator FORD. Well, I am not doing anything unfair. No, I just had a good idea.

Dr. COOPER. You have heard almost a dozen ways in which those systems are in fact manipulated in an unfair fashion.

Senator **Ford**. I am not sure manipulation is a good word. But when you have an agent that is satisfied and you are giving good service and they are making money and you are doing well and you want to break that up, I do not understand that. I do not really understand that, may never.

I am a lot older than you. You will be around to solve these problems after I am gone.

This hearing is adjourned.

[Whereupon, at 12:44 p.m., the subcommittee was adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF MICHAEL H. STYLES, REGIONAL DIRECTOR, U.S. INTERNATIONAL AIR TRANSPORT ASSOCIATION

My name is Michael H. Styles. I am Regional Director for the United States of the International Air Transport Association (IATA). IATA is the trade association of the world's scheduled airlines with 187 members from all corners of the globe.

We appreciate that S.1741 is intended to address questions that have been raised regarding the adequacy of competition among U.S. airlines and is thus directed mostly to domestic issues. IATA has a close interest in domestic aviation developments in the United States because what happens here can have an impact elsewhere. However, with one editorial exception, our comments regarding S.1741 are confined to those provisions that apply to international air transportation.

First, we note that Section 3 of the bill would grant the Federal Trade Commission (FTC) consumer protection jurisdiction over both U.S. and foreign airlines, and presumably over both domestic and foreign air transportation. We urge that this proposal be reconsidered, at least insofar as it applies to foreign air transportation. DOT already has authority under §411(a) of the Federal Aviation Act to deal with consumer protection questions with respect to both U.S. and foreign airlines. Section 5 of S.1741 would strengthen this authority by permitting injunction suits to be brought by DOT in district court. Moreover, insofar as foreign air transportation is concerned, DOT has additional means to deal with consumer protection issues by virtue of its powers in the areas of tariffs, agreements among airlines, foreign air carrier permits, and international certificates of U.S. airlines. It would seem unnecessary--and indeed incongruous--for another agency to have duplicative consumer protection powers. Moreover, unlike DOT, the FTC would not appear to be bound by §1102 of the Federal Aviation Act to act consistently with international agreements. This could lead to conflicts and friction with other governments which may resent U.S. unilateral regulatory intrusion into their airlines or into activities that take place in their territory. DOT is already fully equipped to deal not only with consumer protection but also with resolution of conflicts with other governments. These roles should not be shared with another agency.

We thus recommend that Section 3 of the bill be deleted. Alternatively, if it is still considered necessary to give the FTC jurisdiction over domestic air transportation, we recommend that Section 3 read as follows in order to avoid duplicative authority with the DOT on foreign air transportation issues:

> Section 5(a)(2) of the Federal Trade Commission Act (15 U.S.C. 45(a)(2)), is amended by inserting between the words "air carriers" and "foreign air carriers" the words "when engaged in foreign air transportation."

Secondly, Section 6 of S.1741 would give DOT authority to allow so-called "concentrated hub airports" to assess passenger facility charges as a means of generating revenue for security, capacity enhancement and noise mitigation. These charges would be assessed on all passengers enplaning at the airport, whether domestic or international and whether flying on U.S. or foreign airlines. IATA strongly supports moves to increase systems capacity, which as all know is a serious problem in many parts of the world. We also support strong airport security measures to thwart hijackers and terrorists. However, the instant proposal appears to be designed to address these questions only at concentrated hubs, as defined in the bill. The proposal will do nothing for other airports at which capacity is a problem.

IATA urges that the Congress not pursue yet another tax or charge on airlines or their passengers, particularly in the international arena. International passengers in the U.S. already pay a $3 international departure tax (which may soon be increased to $6), a $5 Customs user fee and a $5 Immigration user fee. Of these already existing fees, charges and taxes, only the international departure tax has a logical and accepted purpose. These taxes are paid into the Airport and Airways Trust Fund and, at least in theory, support the international use of the U.S. airports and airways system. To require that passengers, whether domestic or international, enplaning at certain U.S. airports also pay an additional amount to that airport subverts the entire purpose of the international departure tax and the Trust Fund. We do not believe that any country should try to collect both a departure tax or charge and a fee for enplaning at a particular airport. We urge that the Congress continue to utilize the provisions already available to support and enhance the nation's airports and airways system.

Thirdly, Section 7 of S.1741 would require the Secretary of Transportation by regulation to provide for the withdrawal and tranfser, by auction, of slots held by U.S. and foreign airlines at high density airports. We understand the purpose of this provision is to open up the availability of slots for new entrants in order to enhance competition among U.S. airlines. We take no position on whether this step would enhance competition among U.S. airlines. We note that among the factors that the Secretary must take into account are the "international law and treaty obligations of the United

States". We assume this means that foreign airlines should not be required to purchase slots, by auction or otherwise, at airports at which they have been granted landing rights in bilateral air transport agreements, since such agreements do not provide that designated airlines make payments for the right to exercise those rights. However, while foreign airlines would thus appear to be excluded from the auctioning provisions, U.S. airlines would be covered for the slots they use for international service. This would place U.S. international airlines, most of whom are IATA members, in an unfair competitive position. I note, in passing, that a similar point was made by 15 Senators in their letter of October 10 to the Chairman of the Committee on Commerce, Science and Transportation opposing slot rental fees. We therefore suggest that, if Section 7 is to be retained, the following words be added at the end of paragraph (a): "which have not been allocated under §93.217 for use in international operations."

Thank you for your consideration.

COMMENTS OF THE
MINNESOTA DEPARTMENT OF TRANSPORTATION
OFFICE OF AERONAUTICS
SENATE 1741 -THE AIRLINE COMPETITION ACT OF 1989

The State of Minnesota and Leonard W. Levine, its Commissioner of Transportation, acting by and through Raymond J Rought, Director, Office of Aeronautics, Minnesota Department of Transportation (Mn/DOT), respectfully submits its comments concerning Senate 1741 - The Airline Competition Act of 1989.

Minneapolis/St. Paul International Airport

The Minneapolis/St. Paul International Airport is a major hub which serves all of Minnesota and the Upper Midwest. It is a designated gateway for direct international flights to several destinations including Asia and Europe.

Minnesota Cities with Connecting Service Via the Minneapolis/St. Paul Hub

City	Population
Bemidji	10,945
Brainerd	11,489
Duluth	92,811
Fairmont	11,506
Grand Rapids	7,934
Chisholm/Hibbing	27,123
International Falls	5,611
Mankato	28,651
Rochester	57,948
Thief River Falls	9,105
Worthington	10,243
Winona 1/	25,069
Moorhead 2/	29,998
East Grand Forks 3/	8,537
Marshall	11,165

1/ served through La Crosse, WI
2/ served through Fargo, ND
3/ served through Grand Forks, ND

These communities and many others access the nation's scheduled air transportation system through the Minneapolis/St. Paul (MSP) hub. The hub airport provides an opportunity for convenient connections to cities throughout the system which would not be available to persons traveling in these markets.

Multiplier Effect of Hub Airport

It is obvious that these cities are not large markets. Our point is that a very high percentage of passenger traffic generated in these markets is not going to the hub airport, it is connecting traffic going to a variety of city destinations beyond the MSP hub. For example, only 22.4% of the passengers traveling by scheduled air carrier from Chisholm/Hibbing, MN, to MSP are actually going to Minneapolis or St. Paul (Table 2). Approximately 78% of those passengers are on that aircraft from Chisholm/Hibbing due to the availability and variety of connections at MSP to their ultimate destinations.

These figures are not unique to Minnesota communities. It is typical around the nation that direct convenient access to connections at hub airports will multiply a community's passenger traffic by a factor of three or four times. It is apparent for many of these communities that good connections and the multiplier effect that access to convenient connections to beyond hub destinations is the difference between unsubsidized service and subsidized essential air service.

It is for this reason that we believe hub airports and code-sharing are important factors working in favor of non-hub cities being able to sustain access to the national air transportation system.

Subsidy Reduction

It is particularly noteworthy that by virtue of the MSP hub and code-sharing we have, in Minnesota, been able to build passenger traffic to a point where 7 out of the 10 cities that receive subsidized air service no longer receive such service.

If action were now taken to limit or make hub airports less viable and to outlaw code-sharing, these communities would again be at risk because they do not generate sufficient passenger traffic to economically support direct flights to multiple locations.

Code-Sharing - Marketing Tool

Code-sharing is one of the devices that air carriers utilize to market a community, both nationally and internationally. Typically, commuter air carriers enter into a marketing agreement with a major air carrier serving a hub airport. Through that agreement, the public is offered a variety of service enhancements; schedules coordinated to provide connecting times, use of the same in-house reservation systems through seat assignments, special baggage handling, etc. Also, through the code-sharing agreement, these service advantages to the public can be emphasized by the small carrier through the use of the larger airline flight codes in markets thousands of miles away.

Without code-sharing, it would not be economically feasible for these smaller carriers to market their service or the cities they serve in these distant markets. It would then become difficult for would be travelers in the Los Angeles - Thief River Falls market to determine that they could fly all the way to Thief River Falls or some other non-hub city. In code-sharing arrangements, full notice is provided to the traveler that service is being provided by a separate company.

Is Coding-Sharing Anti-Competitive?

There is nothing to prevent different code-sharing carriers from serving the same markets. The factor limiting competition in non-hub markets is the economics of market size and the operational costs involved in serving such markets.

It is ironic that Senate 1741 proposes to eliminate code-sharing. To do so would harm the scheduled air transportation prospects of many non-hub markets and make it more difficult for persons traveling in these city-pair markets. Outlawing code-sharing would expand the potential for increased federal subsidy to airlines by adding new cities to the EAS role and raising the price of air fares beyond reason in these smaller markets served by the code-sharing carriers.

In our area, the pricing policies which have evolved for city destinations beyond the hub airport have helped to stimulate traffic in these markets. The add-on fare to regular business fares between MSP to major destinations and Bemidji, MN, is $25. For example, the regular Y fare from MSP to DCA is $355, the same fare from BJI to DCA would be $380 (Table 4). The stated purpose of this program is to encourage the persons traveling to and from the non-hub markets to use the scheduled air service that is available through the local airport. This helps to foster scheduled air service within our state, since a majority of the air travel is to destinations beyond the MSP hub (Table 3 and 4).

Hub airports are the most important and certainly the most successful device for fostering and sustaining scheduled air service to cities of all sizes. Hub airports provide air carriers with the wherewithal to aggregate their traffic to many destinations and to sustain air service to a variety of markets, some of which would not receive nonstop service without the ability of air carriers to aggregate traffic at the hub. Table 5 shows that in addition to the Northwest hubbing activity, 16 airlines provide 616 weekly nonstop flights from MSP to the destinations shown.

To the extent the operation of hub airports is impaired, it is small- and medium-sized cities which will be the first to suffer. MSP-NYC is a market that would, in all probability, always have scheduled air service whether or not there is a hub a MSP. However, without a major hub at MSP, communities such as Brainerd, Bemidji, Duluth and other similar sized cities in the Upper Midwest would not, in all probability, have viable scheduled air service to multiple destinations. This fact is not limited to Minnesota, it is true for a majority of cities around the nation.

Conclusion

In conclusion, we believe that hub airports are instrumental in developing scheduled air transportation to markets of all sizes. The ability of major carriers to aggregate the traffic at hub airports makes it economically feasible for the public to travel to and from more destinations; destinations which may not be able to support scheduled air service if it were not for the hubbing ability of air carriers and code-sharing.

Code-sharing and hubbing have a multiplier effect on passenger traffic in the non-hub markets, which works to help maintain subsidy free service in many of these markets.

Table 2

THE MINNESOTA SPOKE MARKETS ARE NORMALLY SMALL WITH A WIDE DIVERSION OF AIR TRAVEL

Fourth Quarter 1988

Minnesota City	Total Market		Twin Cities Market			No of City Pairs (Other than MSP) Psgrs Per Day of	
	Total Psgrs	City Pairs	Distance	Psgrs	Percent Of Total	Five Or More	Less Than Five
Bemidji	10,010	102	199	2,720	27.2%	1	1.0%
Brainerd	6,720	95	113	650	9.7%	1	1.1%
Duluth	50,450	140	144	4,460	8.8%	30	21.4%
Grand Rapids	2,070	55	161	440	21.3%	-	-
Hibbing	8,390	84	174	1,880	22.4%	-	-
International Falls	6,980	85	254	2,380	34.1%	-	-
Rochester	45,730	135	76	2,170	4.7%	25	18.5%
Thief River Falls	3,710	61	261	1,790	48.2%	-	-
Moorhead 1/	66,260	137	223	15,120	22.8%	31	22.6%
East Grand Forks 2/	43,470	129	284	7,450	17.1%	26	20.2%

1/ Served through Fargo.
2/ Served through Grand Forks.

Source: U.S. DOT Airline Traffic Survey.

Table 3

FLY/DRIVE ADD-ONS TO TWIN CITIES FARES FOR MINNESOTA SPOKE CITIES

City	Nonstop Air Mileage From MSP	Add-On to Twin Cities Fare Business (OW)	Leisure (RT)
Bemidji	199	$20	$20
Brainerd	113	25	20
Duluth	144	15-20	20
Grand Rapids	161	25	20
Hibbing	174	30	30
International Falls	254	40	40
Rochester	76	10	10
Thief River Falls	261	30	20
Moorhead 1/	223	20	20
East Grand Forks 2/	284	30	20

OW - One way
RT - Roundtrip

1/ Served through Fargo.
2/ Served through Grand Forks.

Table 4

ILLUSTRATIVE AIR FARES THAT RESULT FROM APPLICATION OF THE FLY/DRIVE PRINCIPLE

Fare Class	Mpls St. Paul	Brainerd	Bemidji	Thief River Falls	Chisholm/ Hibbing
	Between Washington, D.C. and				
QXE14N	$208	$228	$238	$238	$238
QWE14N	238	248	258	258	258
HXE70P25	248	268	278	278	278
HWE70P25	278	288	298	298	298
MAP3	274	299	304	304	304
BAP3	329	354	359	359	359
Y	350	378	380	380	380
QZ6N	159	-	189	189	-
MIAD	259	-	289	289	-
BIAD	314	-	344	344	-
	Between Los Angeles and				
QXE14N	$308	$318	$328	$328	$328
QWE14N	348	358	368	368	368
HXE70P25	368	378	388	388	388
HWE70P25	408	418	428	428	428
B	361	396	401	401	401
Y	446	470	478	478	476

Table 5

AND IN ADDITION TO NORTHWEST'S HUB THERE ARE 616 WEEKLY

NONSTOPS FROM THE TWIN CITIES ON 16 AIRLINES TO 26 DIFFERENT CITIES

From MSP To	Weekly Nonstop Flights AA	US	BN	CH	CO	CP	DL	HP	JV	ML	OZ	PA	TW	UA	WV	SK	Total
Atlanta							21										21
Bemidji				11													11
Cleveland					20												20
Charlotte		14															14
Cincinnati							21										21
Denver					27									27			54
Dallas	28																28
Fairmont																17	17
Houston					21												21
New York-JFK												7	7				14
Las Vegas	7							7									14
Los Angeles	7																7
Kansas City			27														27
Chicago-MDW										61							61
Mankato				17													17
Marshall															11		11
Chicago-ORD	42													71			113
Phoenix								19									19
Pittsburgh		21															21
San Francisco														7			7
Salt Lake City							28					7					35
St. Louis													38				38
Kenora											2						2
Regina						7											7
Thunder Bay									12								12
Spencer IA																4	4
Total	84	35	27	28	68	7	70	26	12	61	2	14	45	105	11	21	616

Testimony of

A.B. Magary

Executive Vice President-Marketing

Northwest Airlines

to the

Senate Commerce Committee's

Aviation Subcommittee

November 8, 1989

Mr. Chairman, on behalf of Northwest Airlines I am pleased to have this opportunity to comment on S.1741.

Overall we believe the various provisions of this bill would harm the interests both of passengers at the hubs and of those at smaller communities, would threaten the ability of hubs to serve both the economic development interests of hub communities and the interests of passengers in getting the most efficient possible routing to the maximum possible number of destinations, would cause unnecessary termination of existing air service on some routes, and in general would harm the very consumer interests it purports to serve. We therefore oppose the bill.

We note, however, that the CRS divestiture provisions of the bill constitute a long-overdue willingness to address the most serious of all anti-competitive factors in the airline industry:

the powerful and enduring nationwide duopoly of the two dominant CRS systems. The willingness to address this fundamental problem has been largely lacking to date, yet CRS is a problem which will have to be addressed effectively in order to sustain the competitive forces on which the public benefits of deregulation are based.

I will comment first on the provisions of the bill other that CRS divestiture and then will return to that subject.

Code-Sharing. To understand the issue of code-sharing we first need to understand the importance of hubs to small community service.

The early years of deregulation saw wholesale abandonment of smaller communities by jet carriers. Airlines did not have route systems which could attract sufficient passenger traffic to those smaller cities. Particularly as Federal subsidies for jet service to small communities[1] were eliminated, the absence of sufficient passenger traffic on these routes often resulted in the termination of service.

In the last few years there has been at least a partial reversal: airlines are serving more small communities and the airline demand for aircraft is greatest at the smaller end of the spectrum: the 2-engine jets. The cause of this reversal has been the creation of more hubs and of route systems more oriented toward hubs. A hub creates many connecting opportunities -- often dozens of connecting flights -- for each in-bound flight. The fundamental result of that is that there no longer needs to be enough passenger traffic from city A to the hub to justify the service. Now the test is a much easier one: is the passenger traffic from city A to the hub, when combined with the passenger traffic from city A and going to all of the dozens of other cities to which that hub offers connections, sufficient to justify a flight from city A to the hub? This ability of the hub to aggregate traffic is key to the viability of air service to smaller communities. In fact, it is now typical of our flights from smaller cities to our hubs that nearly three-quarters of the passengers on board are not going to the hub city, but to some city beyond the hub to which we offer a connecting flight. If we did not have a hub that created all those connecting opportunities, then three-quarters of all the passengers on the flight from the small city would not be on that flight, which often means that the flight would not exist.

---

[1] Sec. 406 subsidy program

With this aggregating effect of hubs we can serve a great many smaller cities, examples of which would be Duluth, Fargo, Sioux Falls, Madison, Huntsville, Chattanooga, and so on. However, even with this aggregating effect of hubs, there are many cities too small to justify jet service, but which could use our hubs to generate passenger traffic sufficient to justify frequent commuter air service. It was to accomplish exactly this purpose that code-sharing became widespread.

In order to allow the smaller communities to benefit from this traffic-aggregating effect of our hubs, we enter into a marketing agreement with a commuter carrier. That commuter sells a connecting service that is in many ways identical to the connecting service we would sell if we could serve that community: the passengers reservations are made in our system, their seat assignments are made not only on the first segment provided by the commuter but also on the subsequent connecting segments, their baggage is checked through to their final destination, and so on. We and our commuter partner provide, in effect, an on-line level of connecting service. We bring that special level of service to the attention of travel agents, and through them to consumers, by sharing our airline code with our commuter partner. That results in our connecting flights being given the same level of display in CRS's accorded to on-line connections, which is entirely appropriate given the fact that that is in fact the level of service we and our commuter partners provide.

Another result (and this is the most important one in the view of small communities) is that the passenger traffic at their community almost invariably increases, often substantially, as compared to service provided by a non-affiliated commuter. For small communities struggling to sustain air service, the code-sharing commuter has been welcome news because it allows even these smaller communities to benefit from the traffic aggregating effects of our hubs. It is also true for our commuter partners, as it is for us, that an average of nearly three-quarters of their passenger traffic is not going to the hub city but is connecting at the hub to points beyond.

Code sharing is how we and our commuter partners can keep air service viable to a great many communities, including such communities as Fayetteville, Arkansas; Brainerd, Minnesota; Watertown, South Dakota; and Owensboro, Kentucky.

Section 2 of S.1741 would prohibit code-sharing. There are only two possible consequences of that action. One is that much of what we have been able to do to strengthen passenger traffic to small communities would be undone and the viability of that service would be jeopardized. Traffic levels to these communities would suffer, although exactly how much would vary from community to community. The demands on the Essential Air Service subsidy program, already stretched thin, would be increased.

The second possible consequence is that, rather than see this "feed" traffic from smaller communities decline, airlines would seek to preserve the effects of their present code-sharing partnerships and would do so by buying their commuter partners, which would allow those same flights to continue using the larger airlines codes. The ironic result would be that the market share of the largest airlines at each hub would thereby increase, precisely the opposite effect intended.

The result of this provision therefore would be either to harm small communities or to increase large carrier concentration at the hubs.

There is no issue of consumer deception here: DOT regulations require us to inform each consumer calling regarding any of our code-sharing connections that one of the segments is provided by a separate commuter company, and we are required to so indicate in all our CRS schedule displays. Furthermore, while consumers complain to DOT about all kinds of problems regarding airlines, there have been in recent years virtually no complaints to DOT about code-sharing being deceptive. The problem to which this counter-productive remedy is being proposed simply does not exist.

Federal Trade Commission. Section 3 of the bill would duplicate the DOT's existing authority[2] over unfair and anti-competitive practices at the FTC. The effect of giving the exact same authority to two different agencies would be confusion and bureaucratic in-fighting, not better regulation or enforcement. Neither consumers nor airlines would be well-served by the uncertainty about where to take a problem and the buck-passing about who should solve it.

The Congress thoroughly examined this question in its 1984 deliberations on the CAB Sunset Act, and concluded that giving duplicate authority to two different agencies would be the worst of all possible outcomes. Because DOT would in any event retain that authority over international aviation, and because it would be undesirable for a passenger making a domestic connection to an international flight to have to go to two different agencies for relief, Congress chose to keep this authority at DOT. That was the right decision then and nothing has changed since to alter that conclusion. Particularly when you consider that rulemaking is so slow as to be almost impossible at the FTC (given the Magnuson-Moss Act, which applies to FTC but not to DOT), and that issuance of stronger rules on CRS monopoly power is the most important pro-competitive action which could be taken at this time, the alternative of giving this authority to FTC is not a attractive one.

---

2. In Section 411 of the Federal Aviation Act.

It is true that DOT has not always used this authority as fully as it should. We for example have had a complaint[3] pending at DOT for over 17 months, seeking simply to have DOT enforce its existing CRS rules with regard to minimum use clauses. There has been no action in response to our complaint. Various travel agent groups have had similar petitions with regard to CRS rules pending for far longer, also without action by DOT. Nevertheless, it seems to us that the remedy for these problems is for Congress to urge DOT to fully use its existing authority, rather than for Congress to duplicate the assignment of that authority in ways that simply will not work.

Concentrated hubs. Section 4 of the bill would declare any airline which had 40 percent or more of the enplanements at any of approximately 35 of the larger airports, or any airline if it was one of two airlines with over 60 percent of the enplanements, to be presumed guilty of violating statutory prohibitions against "unfair or deceptive practices or unfair methods of competition."

Section 5 gives DOT the authority to enjoin airlines from having market shares above those standards.

This country has had anti-trust laws for almost 100 years. In that time it has never been considered a crime simply to have a market share above any specified level. Our laws have always recognized that there were often perfectly legitimate reasons for high market shares. These might include having a better product, a lower price, a more efficient means of production, or a greater commitment of resources to a given market. High market shares which result for these reasons should not be a crime; they are in fact the marketplace working in the public interest.

---

[3] Docket Number 45641.

It has been suggested that this presumption of guilt would be a rebuttable presumption. Normally in our system of law the rebuttable presumption is that one is innocent; the burden of proof must be borne by those alleging guilt. To now make virtually every large airline, and several smaller ones (including America West, Southwest, Presidential, and Midway[4]), presumed guilty until they can establish their innocence puts an entirely prejudicial burden on them without having established that they have done anything wrong. It puts the judicial cart before the horse.

We question the wisdom of presuming guilt not simply because we expect always to be a defendant. In fact, we have for some time been one of the plaintiffs in one of the largest anti-trust suits of recent years. In that case we have to carry the burden

---

4. Based on 1988 data on hub size, HHI's, and carrier enplanement.

of proof, and it is a significant burden. We nevertheless believe it is properly our task to establish the guilt of those we accuse without benefit of any prior declaration by statute that they are presumed guilty.

Furthermore, whether the effect of Sections 5 and 6 would be to reduce airline operations at some or all hubs, and whether that effect would occur following lengthy trials or before them in an attempt to avoid prolonged litigation, it is highly doubtful that these reductions in air service would serve the interests of hub communities. Hub cities typically have 2 to 3 times more air service (meaning much greater schedule frequency to many more non-stop destinations) than they would if they did not have a hubbing carrier. Put another way, the large flow of connecting passengers using that hub supports a level of air service far beyond what that community could sustain on its own. With that higher level of air service comes many more jobs, often thousands more, provided by the hubbing carrier; more jobs in hotels, food-service, ground transportation, conventions, and tourism; more fuel sales; and most importantly, greater ability to compete for businesses deciding where to locate new facilities, since convenient air service is a major factor in many such decisions. To the extent these provisions would result in hubbing carriers reducing air service at hubs, these benefits would be diminished for hub cities.

To take Northwest's major hubs as examples, if these provisions were effective, we would have to reduce our air service to the Twin Cities and to Memphis by approximately half and to Detroit by approximately one-third. Would those communities be better off if we did that? Would they think so? Since the purpose of these provisions is to benefit approximately 35 hub communities by protecting them from the negative consequences of being a hub, perhaps the Committee should first ask these communities whether they want their leading air carriers to provide them dramatically less air service. Does Pittsburgh want USAir to pull out over half its service? Does Chicago want United and American to pull out one-quarter of their service? Or Midway to pull out over one-third of its service? Does Cincinnati want Delta to pull out half its service? Does Baltimore want USAir to pull out one-third of its service? Does Dallas want American and Delta to pull out one-third of their service? Does Salt Lake City want Delta to pull out half its service?[5]

Those are just some of the service reductions which would have to occur if carriers took the steps required by this legislation to avoid being presumed guilty. Would any public interest be served by those service reductions? We think not.

---

[5] Based on 1988 data on hub size, HHI's, and carrier enplanements.

Several months ago we used DOT data[6] on average fares paid by passengers to compare the fares at each of our major hubs, at which we are the only hubbing carrier, to the nearest hub where two major carriers had competing hubs at the same city. In other words we compared our average fares at the Twin Cities to those of United and American at Chicago O'Hare, ours at Detroit to those of United and American at Chicago O'Hare, and ours at Memphis to those of Delta and Eastern at Atlanta. We found that in five out of those six comparisons our fares generally were the same or lower than those of the airlines at the cities with two hubbing carriers. So if there is no fare advantage in having two hubbing carriers rather than one, and if there are major service and economic development disadvantages in having no hubbing rather than one, what public interest would these provisions serve in forcing carriers to reduce their service at hub cities?

Not only would the public interest at the hub cities not be served, neither would the public interest at smaller communities be served. If we are required to reduce our hub operations by half, our passenger traffic to smaller communities would be reduced typically by 30 to 40% due to lost connecting traffic. Traffic margins to those communities normally are already thin, so significant reductions would jeopardize service. At the very least, communities now served by our smaller jets would likely be reduced to commuter service; those now served by our commuter partners without EAS subsidy would likely find themselves dependent on EAS subsidy to try to sustain any service at all, and it quite possibly would no longer be a commuter with on-line connection service at the hub. And given recent funding uncertainties and restrictions on the EAS program, becoming dependent on EAS subsidy is a prospect which gives small communities no comfort.

---

[6] DOT Database 1A; the then most recently available data was the first quarter of 1988.

In short, with reduced hub operations would come reduced connecting traffic, and reduced connecting traffic would jeopardize service disproportionately to the smaller communities. There is enough local traffic from the Twin Cities to New York, or from Detroit to Los Angeles, to sustain non-stop service without the connecting traffic provided by a hub. There simply is not enough local traffic to sustain jet service from Duluth to the Twin Cities or any service from Watertown to the Twin Cities. These smaller destinations would pay a high price for reduced hub operations.

One final point regarding the hub concentration provisions of this bill: in many instances this bill would declare guilty airlines which not only do not have monopoly power at an airport, but which do not even have a significant presence at an airport. Among those declared guilty by this bill would be United by virtue of having a 5.2% market share at the Twin Cities; Delta by virtue of having a 2.1% market share at Charlotte; and Southwest by virtue of having a 3.5% market share at St. Louis.[7] Clearly no one believes these airlines are in a position to exercise monopoly power at those cities, nor that their market shares at those cities are excessive.

Monopolistic, unfair, or deceptive practices are against the law no matter what a company's market share, and that is as it should be. To create a presumption of guilt for all companies based only on their market shares and not on any evidence of monopolistic, unfair, or deceptive behavior would only divert attention and enforcement resources from those practices which are of real harm to the public.

Passenger Facility Charges. Section 6 of the bill would lift at approximately 35 of the larger airports the long-standing federal prohibition against airport taxes levied directly against passengers.

Congress has imposed an 8% ticket tax on passengers, the proceeds of which are dedicated to providing grants for airport expansion and to modernizing and expanding air traffic control capacity. In order to prevent double taxation of passengers, Congress barred local airports from imposing their own per passenger taxes on top of the 8% ticket tax. Through the 8% ticket tax passengers have paid more than enough to accomplish the purposes for which the tax was created. Other problems, including federal budget constraints and a slower-than-forecast procurement program at FAA, have prevented those taxes from being utilized as fully as projected or as needed. So taxpayers have gotten less than they have paid for in the way of airport and airway capacity: the excess of their payments now accumulates in the Trust Fund surplus.

---

[7] Based on 1988 data on hub size, HHI's, and carrier enplanements.

To now say that we are concerned that capacity restraints threaten competition and that our cure is to allow an additional tax on passengers would be to penalize taxpayers for the government's failure to fully utilize the taxes already paid. It is hard to see how adding a second layer of taxes on top of a first layer that is not being fully used is pro-consumer. If the problem has been the Federal government's failure to fully utilize existing passenger ticket taxes to expand airport and airway capacity, then that problem should be solved. It does no good to punish the passenger for government's failure to properly utilize tax dollars already collected.

It has been suggested that this new tax is necessary because airlines which dominate a hub can use Majority-In-Interest clauses (MII's) to block development of facilities at that airport by competing airlines. This is, however, a complete misunderstanding of what MII's do and what they cannot do. Most airport facility development, particularly at larger airports, is accomplished by the airlines' making commitments to pay off a bond over a number of years, and the proceeds of the bond are used to construct the facility. In order to make the bond salable, the commitment of the airlines is essentially open-ended: the signatory airlines commit to pay whatever is necessary to retire the bond. Given that open-ended ended commitment, the airlines must have clear limits on items included in the rate base: the scope of the project must be clearly finite, since the commitment to pay for that project is so open-ended. MII clauses ensure that the project items _included in the rate base as it relates to that particular bond_ cannot be expanded without the approval of the carriers committed to paying off that bond. Nothing about an MII clause prevents any carrier or group of carriers from launching their own project, using their own funds or a new bond issue, to build whatever new facilities they need. Such projects would not even be subject to MII approval, and therefore no airline or group of airlines can veto an airport project, whether or not an MII clause exists at that airport.

Therefore, not only is a new per-passenger tax a bad choice of remedies, it is also a remedy to a non-existent problem.

High Density Rule Slots. The High Density Rule has, for 20 years, limited the number of airline flights which could be scheduled at 4 specified airports.[8] The High Density Rule is an anomaly under deregulation, since by its very nature it limits the access of new competitors to some degree. It was, however, as much an anomaly when Congress chose to deregulate the airline industry in 1978, and the HDR is no more extensive in its effects today than it was in 1978.

The limitation on new competition inherent in the HDR can be made better or worse depending on the method used to allocate these limited slots. The worst period was in the early 1980's, when the so-called scheduling committees deadlocked and the result was that incumbent carriers could hold the slots and exclude all newcomers. That situation was improved in December, 1985, when DOT adopted the so-called Buy-Sell rule, creating a secondary market for slots and thereby encouraging some greater degree of fluidity and competitive uncertainty as to who might be offering service from an HDR airport and to what destination. Nevertheless, while buy-sell improved a bad situation, there is no doubt that HDR airports remain at least slightly less open to competitive pressures than non-HDR airports.

---

8. Chicago O'Hare, New York JFK, New York LaGuardia, and Washington National. Originally a fifth airport was included: Newark.

Section 7 of the bill would require DOT to revoke and reallocate all slots. It specifies neither the timetable of the revocation nor very much about the method of reallocation, except that a periodic auction be employed.

The fault in this approach is that it does not correct the underlying incompatibility of the HDR and deregulation. No method of allocation can fully paper over that incompatibility, certainly not the one proposed in Section 7. Its main effects would be to impose new costs on airlines and therefore ultimately on consumers, and to add further revenues to the Airport and Airway Trust Fund when the Federal government has already demonstrated that it cannot or will not spend all of the existing revenues to the Trust Fund for the purposes of the Fund.

Furthermore, to the extent a reallocation of slots occurred, existing patterns of service would be disrupted and some cities (most likely smaller cities) which now enjoy service to an HDR airport would find themselves deprived of this service. Reallocation of slots does not solve the underlying problems of the HDR; it only deprives some cities and carriers in order to benefit others. It does not necessarily benefit competition: if a group of incumbents enjoy some degree of protection from competition by virtue of the HDR, and a new airline is forcibly added to the group, the new carrier will quickly come to behave like the other incumbents, since it too now enjoys that same degree of protection from new competition.

Before embarking down the thankless and ultimately unproductive path of reallocation, Congress should first determine whether and to what extent the HDR itself should continue to exist. It no longer is the most effective way of limiting air carrier operations to fit available ATC capacity. The FAA long ago came to rely much more on flow control, which works at all airports rather than at just 4, and which can adjust demand to fit any level of capacity no matter how constrained. HDR slots, on the contrary, are set at a predetermined level and cannot be adjusted to deal with adverse weather conditions or other operational problems. Furthermore, because HDR limits scheduled operations, as opposed to flow control which limits actual operations, HDR raises competitive concerns which flow control does not. By limiting schedules in advance, HDR gives carriers a higher than normal degree of confidence that they can know who their competition will be and who it will not be. Flow control does not give any higher than normal degree of competitive predictability.

We believe that FAA and DOT should be required to discontinue the HDR slot system except where they can show that HDR is necessary to preserve safety and where no less anti-competitive method is available to achieve an equal level of safety. It has been 20 years since the HDR slot system had to be justified. In that time many things have changed: ATC technology, the development of flow control into a powerful tool, and the increased reliance under deregulation on competition to protect the public interest. Clearly the time has come to either rejustify HDR in the current environment or to scrap it. We strongly suggest that the Congress consider the question of whether to try to adopt a different allocation process only after determining how much of the HDR system needs to be retained at all.

Computer Reservations Systems. The nature of the competitive problem in the airline industry must be understood before it can be solved, and properly understood, that problem is largely a computer reservation system problem.

Consider two industries: one has no competitor with as much as 20% market share nationwide, had operating profits of only 4% during the most recent 5 year period (1984 through 1988) and a rate of return of only 8% over the same period (less than the 12% target rate of return used by CAB when it was regulating air fares). The second is dominated by two competitors who between them have approximately a 75% nationwide market share, and in the 2 years for which the best profitability data are available had between them average operating profits of nearly 50% and rates of return of nearly 90%.[9] Which industry would be the more likely place to look for monopoly behavior? Obviously the second.

In this example, the first industry is air transportation and the second is the CRS industry. The point is that we can debate about which study best answers the question whether there is some type of city where passengers pay a bit more for air transportation than they do at some other type of city, and then we can debate about whether those price differences are justified by cost differences (as costs of providing air service clearly do vary from city-pair to city-pair). But in the end we are playing a zero-sum game in air transportation: the industry has such low profitability -- in fact one of the lowest of all major U.S. industries -- than even if we could prove somehow that the passengers of some city somewhere were being somewhat overcharged it would only prove that those at some other city were being somewhat undercharged. In 1988 the average net profit enjoyed by airlines for each domestic passenger enplanement was only $1.79. There simply are no excess profits in the airline industry to draw down and therefore very little to be gained in pursuing that course. He who believes there is monopoly power in the airline industry must first explain why airlines' financial results show no sign of monopoly profits and in fact show very little in the way of non-monopoly profits.

---

[9] DOT Report P-37-88-2, covering the years 1985 and 1986, based on the accounting method rate of return.

The CRS industry, however, is the classic monopoly power situation, with the two dominant companies able to sustain extraordinarily high profits year after year without threat of losing any significant ground to new competitors. Beginning in 1983 the CRS industry was studied by the Department of Justice, the Civil Aeronautics Board, and General Accounting Office. All found it to be characterized by monopoly power and all found the two dominant CRS's to be immune from new competitive entry. In 1988 DOT confirmed those earlier findings when it issued its study on CRS profitability and found the profit levels of the two dominant CRS's to be extraordinary. In 1988, GAO testified to the House Aviation Subcommittee that CRS prices were twice the cost of providing the service, that CRS prices were determined by monopoly power and not by competitive market forces, that these monopolistic CRS prices resulted in very large financial transfers to airlines owning the two dominant CRS's from other airlines, that these large transfers were reducing competition in the air transportation industry "by artificially imposing a cost penalty on some carriers and subsidizing others," that the dominant position of the two largest CRS's was being preserved by anti-competitive devices in contracts designed to prevent travel agents from choosing alternative CRS's, and that governmental action had to be taken on these CRS abuses "to ensure that the benefits of airline deregulation are not nullified by the anti-competitive effect of airline ownership of CRS's."[10] We agree.

Historically it was only those airlines granted nationwide route systems which had the wherewithal to create CRS's and the nationwide sales forces to sell them to travel agents. Thus it was the government regulator, by creating only two such carriers (United and American) which ultimately determined that two CRS's would emerge first and get most of the larger agents under contract before others were in a position to enter the CRS market.

Airline owners of CRS's originally used biased displays to make it more likely agents would put consumers on their airline, and they got a powerful advantage from the extra traffic and therefore extra revenues they received at the expense of their competitors (known as incremental revenues). When the CAB limited that practice, by issuing in 1984 a rule limiting the role of biased displays, the dominant CRS's simply used their monopoly power in a new way: they dramatically raised the fees paid by other airlines to have their tickets sold through the CRS. Since all airlines have to have their tickets sold through

---

10. GAO testimony: September 14, 1988; House Public Works and Transportation Committee 100-74.

all CRS's in order to reach all travel agents, no airline has any ability to bargain with a CRS about the price to be paid by the airline to sell its tickets through that CRS. Both the airline and the CRS know the airline simply cannot afford not to have its product sold through that CRS. The CRS therefore can raise its prices to extraordinary heights, and has.

Whether because of incremental revenues or high CRS prices, the result has been, as GAO described, an extraordinary financial transfer from those airlines which do not own a dominant CRS to those which do. GAO in its testimony last year estimated that in 1986 alone the CRS-generated transfer from other airlines to the owners of the two dominant CRS's exceeded $400 million. We estimate that in 1988 on average for each ticket sold an airline paid as much to its CRS-owning competitor for monopolistically priced CRS services as it retained for itself in net earnings.

What is happening here is that a basic premise of deregulation is being undermined by CRS. That basic premise was that airlines would achieve financial return in proportion to how good their service was and how attractive their fares were. Instead what has come about is that most of their financial return has been in proportion to their ownership of a dominant CRS.

That fact alone, and the utter failure of the DOT to address this problem in 1985 and 1986 when it became overwhelmingly apparent that the CAB rule was simply replacing display bias with monopolistic CRS prices, were major factors in the restructuring of the airline industry which began in 1986. Airlines without CRS's, faced with enormous new CRS costs and no prospect of any future marketplace or governmental limitation on those costs, disappeared either by failure or by merger. In the same period the phenomenon of new entrant airlines has all but vanished, and for the same reasons.

The three smaller CRS's have been hard pressed to create significant competitive pressure on the big two CRS's, because CRS-agent contracts use a number of anti-competitive devices to make it prohibitively expensive for most agents to change to another system. These devices include liquidated damages clauses, long term contracts, rollover clauses (no longer enforced, but previously an important device for getting agents signed on to new long-term contracts), and minimum use clauses. The purpose of these clauses is to deprive travel agents of continuing free market choice among CRS's and to thereby erect an anti-competitive barrier around the CRS advantage the owners of the two dominant systems enjoy over their competitors.

We disagree with those who say the competitive problems in the air transportation system are localized to a few specific hubs. We believe that the competitive problems in this industry are nationwide, since a dollar transferred to your competitor by CRS is as damaging whether the ticket sold was on a CRS located in your hub, their hub, or at some location which is no one's hub. We believe those nationwide problems are primarily CRS problems. And we believe that until government takes action either to break open the anti-competitive barriers the dominant CRS's have put up around the travel agents they already have under contract, or to break the link between CRS monopoly power and the anti-competitive effect it has on air transportation by generating enormous artificial financial transfers among airlines competitors, or both, the trend toward industry concentration will continue and the prospects for new entrant competitors will remain bleak.

Section 2 of S.1741 takes the approach of breaking the link between CRS monopoly power and the anti-competitive effect it has on air transportation. It does so by requiring airline divestiture of CRS's; in short, a CRS owning airline would have to sell either the CRS or the airline. Despite the fact that we are ourselves a CRS-owning airline, we believe that divestiture is a viable concept and ought to be given serious consideration. It is not a perfect cure for all CRS anti-competitive problems, but those problems are now so extensive that we believe there are no single, perfect remedies. The effect of divestiture would not necessarily be to cure the duopolistic nature of the CRS business, but to prevent that duopolistic nature from causing the transfer of financial resources within the airline industry. The result would be to put all airlines on an equal footing with regard to CRS and to therefore require them to compete with each other on the basis of service and fares, and not on the basis of CRS dominance. The one disadvantage of divestiture is that it would allow the airline owners of CRS's, particularly of the largest CRS's, to get one last massive financial windfall from their CRS in the form of the sale price. Nevertheless, as compared with the status quo, airline competition would be better served by one last windfall than by perpetuating the monopoly control of CRS and CRS-driven revenues.

One criticism which has been levelled at Section 2 is that it would require U.S. airlines to divest their CRS's but would not prevent foreign airlines from buying them. In our view that is a defect easily corrected: the section should be amended to preclude ownership of any CRS operating in the U.S. by any entity which also owns an airline in any country. By stating the prohibition in terms of owning a CRS that operates in the U.S., we believe that no allegation of extraterritorial application of U.S. law would be sustained.

There are other options which should be considered for dealing with the CRS problem. These include:

-- Provisions to create more competitive choice among CRS's by travel agents. We believe that either by statute or by DOT rulemaking, existing contract barriers to CRS competition should be clearly outlawed. Liquidated damages clauses should be prohibited and CRS's prevented from charging more than reasonable removal costs when an agent changes systems. Length of the contract term should be dramatically reduced; we would support a month-to-month term, giving the agent virtually continuous opportunity to exercise his or her free choice as to which CRS would best meet the needs of the agent's customers. Rollover clauses, already disavowed, should be expressly prohibited so that they never return to the industry. Minimum use clauses prevent most agents from using more than one system and as such they violate existing DOT rules against direct or indirect means of preventing agents from using more than one system.[11] Yet DOT has never enforced this rule. It should be made clear that minimum use clauses are prohibited and that DOT will enforce that prohibition. It is our view that any CRS vendor which believes that it has an excellent CRS has no reason to deprive travel agents of a continuing free choice about which CRS to use.

-- Provisions to limit excessive CRS prices and to thereby limit the artificial and anti-competitive financial transfers among airline competitors. The approach of divestiture is to

---

11. 14 CFR 255.6(b).

divert the proceeds of excessive CRS prices away from airlines, rather than to reduce the excessive prices. There are, however, a variety of mechanisms which would limit CRS prices, and these are also viable options which should be considered. The most intriguing of these is to create a right of arbitration for airlines bargaining with CRS's on CRS prices. The concept is that the airlines, which now lack any normal bargaining leverage with the CRS, would regain some of that leverage by having the right to invoke arbitration to determine what a reasonable price structure would be. The granting of such a right might be sufficient to create a more reasonable price structure through more equal bargaining, even if arbitration itself were seldom actually invoked.

Our view is that, given the importance of the CRS problem, it quite likely would be necessary to adopt more than one remedy. What is absolutely clear, however, is that continued inaction on CRS is an abdication of government's responsibility to ensure competition in the air transportation industry and to thereby preserve the benefits of deregulation for the American public. The most essential step which must be taken in order to enhance competition in the airline industry is to end the pattern of government inaction on CRS issues.

Mr. Chairman, we appreciate the opportunity to comment on S.1741.

○